United States Court of Appeals

for the Second Circuit

PETITIONER’S BRIEF

ORIGINAL

75-4087

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SAMUEL H. SLOAN, d/b/a
SAMUEL H. SLOAN & CO.,
Petitioner,

-against-

SECURITIES AND EXCHANGE COMMISSION, et al.,
Respondents.

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P/S

PETITIONER'S BRIEF

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INDEX

CASES: Page No.

CASES: Page No.

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STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Is the decision of the Securities & Exchange Commission to revoke the broker dealer registration of Samuel H. Sloan & Co. and to bar Samuel H. Sloan for life from being associated with any broker or dealer supported by substantial evidence?

2. Has Samuel H. Sloan been deprived of his constitutional rights by an order of the Securities & Exchange Commission which denied his request to withdraw as a broker dealer?

3. Has the petitioner been deprived of his Fifth Amendment due process rights including his right to notice and the opportunity for a hearing in that the order by which these proceedings was commenced failed to appraise the petitioner of the nature and the cause of the accusation against him?

4. Does the Securities & Exchange Commission lack jurisdiction over this controversy because no showing has been made that commerce with foreign nations or among the several states is connected with the events which were the subject of the proceedings before the Securities & Exchange Commission?

5. Does the order of the Securities & Exchange Commission exceed the powers vested in it by statute in that the order has the effect of barring the petition-

er for life from being associated with a broker or dealer whereas Sections 15(b)(5) and 15(b)(7) of the Securities Exchange Act of 1934 only gave the Securities & Exchange Commission the power to effect a bar for a period not exceeding one year?

6. Must the order of the Securities & Exchange Commission be vacated in view of the fact that this administrative proceeding was commenced in retaliation for the refusal of the petitioner to "consent" to a permanent injunction?

7. Did the Securities & Exchange Commission err in refusing to consider the petitioner's allegations of unprofessional and illegal conduct on the part of the attorneys for the Securities & Exchange Commission in this proceeding?

8. Has the petitioner been deprived of a fair trial in an impartial tribunal in that the risk of bias in this proceeding is too high to be constitutionally tolerable?

9. Was the proceeding before the Securities & Exchange Commission conducted in violation of Article III of the Constitution because both the administrative law judge who heard testimony in this case and the Securities & Exchange Commissioners themselves were not appointed for life and therefore were not qualified under the Constitution to act as judges?

10. Was the petitioner deprived of his Fourth and Fifth Amendment rights including the right to be left alone by the constructive and unreasonable search and seizure of his papers and personal effects by officers of the Securities & Exchange Commission and was his right to assert this grievance unconstitutionally chilled by his well founded fear of retaliation from the Securities & Exchange Commission?

11. Is the nature of this proceeding punitive in character and has the petitioner thereby been deprived of his Sixth Amendment constitutional right to a speedy trial before an impartial jury?

12. Are Securities & Exchange Commission rules 15c 3-1, 17a-3, 17a-4, 17a-5, 17a-10 and 17a-11 unconstitutional facially and as applied in this case?

STATEMENT OF THE CASE

This is a petition for review of an order of the Securities & Exchange Commission ("S.E.C.") dated April 28, 1975. The order was entered in a proceeding which was commenced on April 25, 1972 when a three page "order for public proceedings" was mailed to the respondent, Samuel H. Sloan d/b/a Samuel H. Sloan & Co. ("Sloan"). (A14-16)[1]. This order stated that "[a]s a result of an investigation, the Division of Trading and Markets has obtained information which tends to show" that the respondents have "wilfully violated Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder" by failing "to accurately make, keep current or maintain certain of its books and records," that the respondents have"wilfully violated""Section 15(c)3 of the Exchange Act and S.E.C. rules 15c 3-1, 17a-5, 17a-10, and 17a-11 and that on June 24, 1971 the respondents were preliminarily enjoined by an order of the United States District Court for the Southern District of New York. (A15). The order then stated that "[i]n view of the allegations made by the Division of Trading and Markets, the Commission deems it necessary that public proceedings be instituted to determine" whether the allegations set forth are true, to afford respondents an opportunity to establish any defenses and to determine "[w]hat, if any, remedial action is appropriate in the public interest pursuant to Section 15(b) and 15A of the Exchange Act." (A16).

Sloan appeared through counsel, Robert W. Taylor, ("Taylor") (R699), and requested a more definite statement concerning the nature and the cause of the accusations against him. When, certain documentary information proved not to be forthcoming from the S.E.C., Taylor filed a motion dated July 26, 1972 for a more definite statement "so as to narrow down the exact time period or events involved with a view of permitting Respondent to properly prepare its

1. Citations to the appendix (A1-59) and to the supplemental appendix (A60-448) will be designated in this manner. Citations when necessary to the original record filed by the S.E.C. will be preceded by the letter R or Record. Citations to the transcript of the trial before Judge Ward which resulted in a decision reported as S.E.C. v Sloan 369 F. Supp. 996 (S.D.N.Y. 1974) will be preceded by the word "transcript."

defense to such allegations." (R716-717). This motion was strenuously opposed by the S.E.C. (R725-735) and was denied by Ralph Hunter Tracy, the "Administrative Law Judge" to whom this case had been assigned. (A24-26). Judge Tracy did, however, order the S.E.C. to furnish various "net capital computations" and supporting documents which had been prepared by the S.E.C. staff. (A27-28).

A hearing was held from October 30, 1972 until November 1, 1972. The S.E.C. requested (R1018-1020) and obtained (A31) additional time to file its proposed findings of fact and conclusions of law and brief in support thereof and ultimately filed these documents on Decmeber 18, 1972 (R1023). Among other things, the S.E.C. there urged that the Administrative Law Judge adopt a total of 73 proposed findings of fact. (R1026-1044). The respondents proposed findings of fact and conclusions of law were filed on February 27, 1973. (R1107). On April 25, 1973, precisely one year after the administrative proceeding had been commenced, Judge Tracy rendered his "initial decision." (A34-48). This decision stated that "the findings and conclusions herein are based upon the preponderence of the evidence as determined from the record and upon observation of the witnesses." (A36). Although Judge Tracy did not adopt the S.E.C.'s 73 proposed findings of fact, he in substance concluded that all of the rules in question had been violated and ordered that "the registration as a broker dealer of Samuel H. Sloan & Co. is revoked and that Samuel H. Sloan is barred from association with a broker dealer" (A47) unless a timely petition for review was filed with the S.E.C. On May 10, 1973 a timely petition for review was filed (A404-406) and on May 21, 1973 this petition for review was granted. (A49). On June 8, 1973 Taylor requested an extention of time to file a brief and asked Judge Tracy to compel the S.E.C. staff to make available a copy of the minutes of the hearing. (R1179). This request met with opposition from the S.E.C. staff (R1184-1186) which stated that "it was and is not feasible to release the transcript for one week for his [Taylor's] personal use, as requested." (R1185). The S.E.C. maintained the position that

as a result of its contract with the CSA Reporting Service as well as the policy of the S.E.C., it would not let a copy of the transcript out of its office nor would it permit Taylor to make a copy of the transcript. (R1195). On July 3, 1973 Taylors request was denied with the statement that this was necessary "inasmuch as the contract with our reporting service provides that duplicates of such transcript can only be obtained through the reporting service. (R1207)"

On July 20, 1973 the respondent's brief was filed. (R1209-1221). On August 16, 1973, the S.E.C.'s reply brief was filed. (R1226-1239). The S.E.C. then proceeded to deliberate on the matter for nearly two years. Finally, on April 28, 1975, the S.E.C. made its decision which, it said, was "based upon an independent review of the record." (A51 n.2). Although the S.E.C. did not adopt the 73 proposed findings of fact submitted by its staff, nor did it adopt Judge Tracy's initial decision, nor did it adopt any arguments advanced by the S.E.C. staff in its reply brief, it stated that because of"facts and circumstances before us that were unknown to and could not possibly have been foreseen by our staff" (A56 n.24) that Sloan's broker dealer registration would be revoked and that Sloan would be barred from being associated with any broker or dealer. Sloan filed a petition for review from this decision and order which now brings this matter before this court.

Subsequently, Sloan filed with the S.E.C. a motion for an order (1) vacating the order of April 28, 1975 (2) setting this matter down for a new evidentiary hearing and/or (3) staying the order of April 28, 1975 pending determination of a petition for review which has been filed in the United States Court of Appeals for the Second Circuit. This motion was denied summarily and without a statement of reasons on January 7, 1976.

Although that brings these proceedings up to date, this statement of the case would not be complete without a description of certain judicial proceedings which are, in the words of the S.E.C., "closely intertwined" (A52) with this

administrative proceeding.

On June 17, 1971 the S.E.C. filed a complaint in the United States District Court for the Southern District of New York which alleged that Samuel H. Sloan & Co. and Samuel H. Sloan had violated S.E.C. Rules 15c3-1, 17a-3, and 17a-4. S.E.C. v Sloan & Co. 71 Civil 2695. On June 21, 1971 the S.E.C. obtained a temporary restraining order which was served upon the Chemical Bank where Sloan maintained his account. As a result, the sum of $37,999.03, which represented all of the funds which Sloan had in this account, were attached pursuant to a telephone request by the S.E.C. (A429). On June 23, 1971 the S.E.C. appeared in court and stated that it was prepared to lift the freeze on Sloan's bank account provided that Sloan would "consent" to a preliminary or a permanent injunction. After a lengthy colloquy, Sloan agreed to "consent" to a preliminary injunction and, when this was done, the freeze on Sloan's bank account was lifted.

In the months that followed, the S.E.C. contacted Sloan directly or through counsel on many occasions in order to urge Sloan to consent to have the preliminary injunction made permanent. The S.E.C. indicated that if Sloan did not give his consent, an administrative proceeding would be commenced. (A430). Sloan refused to consent and ultimately the threatened administrative proceeding was in fact begun. At various times before and after the commencement of this administrative proceeding, Sloan attempted to file various amendments to his broker dealer registration to reflect a change of partnership status, change of address and other changes. In all cases, the S.E.C. refused to accept these filings. In September, 1973 Sloan filed a request to withdraw his broker dealer registration. (R1240). In a letter dated December 3, 1973, the S.E.C. advised Sloan that "a voluntary broker-dealer withdrawal at this point is unacceptable and clearly represents an attempt to vitiate the integrity of Commission administrative proceedings." (A437).

Meanwhile, the lawsuit which had been commenced by the S.E.C. in 1971 was still before the courts. In July, 1973, Sloan's counsel, Taylor, filed a motion requesting that the court order the S.E.C. to produce the administrative proceeding transcript "for inspection and copying." This motion was denied in a decision reported as S.E.C. v Samuel H. Sloan & Co. 369 F. Supp. 994 (S.D.N.Y. 1973). At about this time, the S.E.C. started its own investigation of Taylor and required Sloan to turn over all correspondence and cancelled checks relating to Taylor's representation of Sloan. Sloan thereafter discharged Taylor as his attorney and, on December 11, 1973, went to trial in the United States District Court for the Southern District of New York appearing pro se. This trial resulted in a decision adverse to Sloan which was reported as S.E.C. v Samuel H. Sloan 369 F. Supp. 996 (S.D.N.Y. 1974). On June 24, 1974 Sloan commenced his own pro se suit against the S.E.C. entitled Sloan v S.E.C. 74 Civil 2792 (TPG). That action was dismissed on February 27, 1975 and the dismissal was subsequently affirmed on appeal. Sloan v S.E.C. slip.op. 2377 (2d Cir. March 4, 1976) modified (2d Cir. April 16, 1976). In November, 1974, Sloan commenced another proceeding by filing a petition for review for various orders of suspensions of trading in Canadian Javelin Ltd. This petition for review was dismissed without prejudice on October 15, 1975 and a petition for rehearing was denied on January 21, 1976. See Sloan v S.E.C. 527 F. 2d 11 (2d Cir. 1975). cert. pending (Docket No. 75-1507).

On December 30, 1974, the S.E.C. commenced its second lawsuit against Sloan and obtained a temporary restraining order on the same day. On January 8, 1975 Sloan filed a petition for a writ of mandamus entitled Samuel H. Sloan v Hon. Robert J. Ward and Hon. Thomas P. Griesa Docket no. 75-3001. This petition was denied on January 16, 1975. On January 17, 1975 Judge Ward entered an order of preliminary injunction against Sloan.

All of these proceedings, with the exception of Sloan's petition for review in 74-2457, involve facts and circumstances incorporated in one way or another

in the decision of the S.E.C. dated April 28, 1975. In addition, there have been other proceedings and a number of appeals have been taken. As a result, there have been a variety of judicial and administrative proceedings which have a direct or an indirect bearing on the facts and the law of this case.

SUMMARY OF ARGUMENT

The decision of April 28, 1975 is not supported by substantial evidence. The S.E.C.'s decision is based at best upon fragments of testimony by two S.E.C. staff investigators which are in many cases contradicted by other testimony from the same S.E.C. staff investigators. The bulk of the "evidence" submitted in this case consists of calculations and computations made by these S.E.C. staff investigators. These calculations and computations are based largely upon conjecture and speculation and cannot even be characterized as hearsay. There is no testimony or evidence which proves the underlying facts upon which these computations are supposedly based and it is clear that these computations cannot and do not satisfy the burden of proof or meet any kind of substantial evidence test. Moreover, almost every question asked at the administrative hearing by the S.E.C. attorney in charge of this case was leading and frequently the answers were provided along with the questions. The Administrative Law Judge invariably overruled objections made to this point, and in addition, repeatedly stated that he would admit hearsay testimony. This was error in view of the fact that there is no statute or regulation which permits the admission of hearsay evidence in an administrative proceeding before the S.E.C.

In spite of the great latitude which the S.E.C. Administrative Law Judge provided to the S.E.C. Attorney who was prosecuting this case, the findings of the S.E.C. are supported by nothing more than a scintilla of evidence and often by no evidence at all. The decision of the S.E.C. rejects the findings of the administrative law judge and makes its own fact findings but the S.E.C. Commissioners themselves did not observe the demeanor of the witnesses and there-

fore could not make a determination as to their credibility. The S.E.C. Administrative Law Judge, noting conflicts between the testimony of Sloan and that of the two S.E.C. investigators who testified for the S.E.C., stated that Sloan's testimony was "not worthy of belief." However, at the trial before Judge Ward in S.E.C. v Sloan 71 Civil 2695, one of the S.E.C. investigators in effect recanted the testimony upon which the Administrative Law Judge based his initial decision and as a result the testimony of the S.E.C.'s witnesses must be considered to have been impeached. Throughout this case, the S.E.C. staff repeatedly misrepresented facts and evidence. This accounts in part for the length and the varied course of these proceedings and requires that the administrative order be set aside.

The findings of the S.E.C. are not supported by substantial evidence for another reason in that approximately one half of the S.E.C.'s decision concerns events which occurred after the hearing in October and November of 1972 and which were not alleged in the order commencing public proceedings dated April 25, 1972. Specifically, the S.E.C. based its decision upon facts found by Judge Ward concerning events which occurred in 1973 as well as upon events which took place in various judicial proceedings in 1973, 1974 and 1975. Sloan was not given an opportunity to present his defenses to any of the allegations which were made for the first time in the decision of the S.E.C. dated April 28, 1975 and as a result he was deprived of his Fifth and Sixth Amendment Rights. In addition, his First Amendment rights to Freedom of Association and Freedom to Petition the Government for a Redress of Grievances were chilled by this decision.

Sloan was also deprived of his constitutional right to withdraw his broker dealer registration. For that matter, the broker dealer registration requirement itself is unconstitutional.

The S.E.C. lacked jurisdiction over this controversy because nowhere in the decision of the S.E.C. or elsewhere in the record was a showing made that Sloan

engaged in commerce or in commerce among the several states. Moreover, no violation of statute was proven because the S.E.C. did not even prove that a single purchase or sale transaction had taken place in connection with any of the alleged rule violations.

The S.E.C. lacks the statutory authority to enter an order of the type entered here because the statute provides that a person may be barred for a period not exceeding one year whereas Sloan, in effect, has been barred for life. Moreover, the order of the S.E.C. must be vacated because the risk of bias in this proceeding is too high to be constitutionally tolerable. It is clear that this proceeding was commenced in retaliation for Sloan's refusal to "consent" to a permanent injunction. In addition, the S.E.C. erroneously refused to consider Sloan's charges of unprofessional conduct on the part of the S.E.C. attorneys who conducted this administrative proceeding and in addition refused his request for a hearing so that he could prove by documentary evidence that perjured testimony well known to the S.E.C. attorneys who conducted this case had occurred during the course of the administrative hearing.

The entire proceeding itself was unconstitutional in a number of respects. The proceeding **is primitive in nature and has resulted in an unconstitutional bill of attainder.** The Administrative Law Judge was not appointed for life and neither he nor the S.E.C. Commissioners were qualified to act as judges within the meaning of Article III of the Constitution. Moreover, Sloan was deprived of his Fourth and Fifth Amendment rights in that all of the records and documents upon which the S.E.C. based its case were derived from an unreasonable and therefore illegal constructive search and seizure of Sloan's personal financial records and Sloan's constitutional right to protest timely was chilled by his well founded fear of retaliation from the S.E.C. In addition, this proceeding is legislative rather than judicial **in character and does not involve a** "case" or "controversy" and therefore is barred by Article III of the Constitution. Sloan has been deprived of his Sixth Amendment right to a speedy trial by an impartial jury as is required in all criminal prosecutions such as this

administrative proceeding. Finally, S.E.C. rules 15c 3-1, 17a-3, 17a-4, 17a-5, 17a-10 and 17a-11 are unconstitutional facially and as applied in this case under the Fourth and Fifth Amendments, under the "required records" doctrine established by numerous Supreme Court decisions and because the records and reports required by the S.E.C. are not reasonably related to a specific purpose.

ARGUMENT

POINT I

THE SECURITIES AND EXCHANGE COMMISSION DEPRIVED THE PETITIONER OF HIS CONSTITUTIONAL RIGHTS BY REFUSING TO PERMIT HIM TO WITHDRAW HIS BROKER DEALER REGISTRATION AND THE BROKER DEALER REGISTRATION REQUIREMENT ITSELF IS UNCONSTITUTIONAL.

Before discussing the evidence in this case, it should be noted that Sloan's constitutional rights were violated long before this matter was concluded when the S.E.C. refused to permit Sloan to withdraw his broker dealer registration. This is unconstitutional. This point was judicially decided in one of the first cases involving the S.E.C. In Jones v S.E.C. 298 U.S. 1 (1936), the S.E.C. commenced an administrative proceeding to revoke a 1933 Act registration statement. When an attempt was made to withdraw this registration statement, the S.E.C. ruled that it would not permit the statment to be withdrawn and that its administrative proceeding would go forward. However, the Supreme Court of the United States subsequently reversed an order obtained by the S.E.C. in an application to the district court which required the respondent to appear and give evidence to the S.E.C. In its decision, the Supreme Court compared the actions of the S.E.C. to the "intolerable abuses of the Star Chamber." 298 U.S. at 28.

That decision is still law. To this day, if the S.E.C. commences a proceeding to revoke a 1933 Act registration statement, that statement can be withdrawn at any time as a matter of right. There is no difference between the 1933 Act and the 1934 Act which requires a different result here. In fact,

the same considerations which led the Supreme Court to its decision in Jones v S.E.C. are present in this case in more abundant form. Had Sloan been permitted to withdraw his broker dealer registration statement in September of 1973, the administrative proceeding would have become moot and, in addition, a multiplicity of litigation would have been avoided. The first injunction proceeding in which the S.E.C. alleged that there was danger that Sloan might violate the rules which apply only to registered broker dealers could have been dismissed and the five day trial which then ensued before Judge Ward could have been avoided. The same is largely true of the numerous other judicial proceedings involving Sloan and the S.E.C. which have taken place since that time. In short, had Sloan not been a broker dealer from September, 1973 until April, 1975, the S.E.C. could not have alleged that there was an immediate and real danger that Sloan might violate the rules which apply only to registered brokers and dealers, see Golden v Zwicker 394 U.S. 103, 109 (1969), and therefore the S.E.C. would not have been entitled to request and obtain injunctive relief.

Presumably, the rationale behind refusing to permit Sloan to withdraw as a broker dealer was that Sloan could apply at a later date for readmission. However, this consideration was also present in Jones v S.E.C. and the Supreme Court ruled that this should not act as a barrier to withdrawal.

The S.E.C. also deprived Sloan of his constitutional rights by requiring him to register as a broker dealer in the first instance. It has been held that the creation by the government of a minority class of persons and the establishment of laws and rules which apply only to them is unconstitutional. Railway Express Agency v New York 336 U.S. 106, 112-113 (1949) (Jackson, J., concurring).[2] In effect, Congress and the S.E.C. has created a special class of persons, i.e., brokers and dealers, who are apparently considered "inherently suspect of criminal activities" and has created a variety of laws and rules

2. It is now firmly established that the federal government, like the states, may not deprive a person of the equal protection of the law. Weinberger v Wiesenfeld 420 U.S. 636 n.2 (1975).

which require, among other things, that these persons register with the federal government. It was established in <u>Albertson</u> v <u>Subversive Activities Control Board</u> 382 U.S. 70, 79 (1965) that such an arrangement is unconstitutional.

Subsequent Supreme Court decisions based upon Albertson have been established that statutes which require that records be maintained by a select group about activities in an area "permeated with criminal statutes" are unconstitutional. See <u>Marchetti</u> v <u>United States</u> 390 U.S. 39, 47 (1968); <u>Grosso</u> v <u>United States</u> 390 U.S. 62, 64 (1968); <u>Haynes</u> v <u>United States</u> 390 U.S. 85, 96 (1968); <u>Leary</u> v <u>United States</u> 395 U.S. 6, 16 (1969). The Securities Exchange Act of 1934 is, of course, a criminal statute, (see Section 32, 15 U.S.C. §78 ff) and Sloan has been frequently accused by the S.E.C. of violating that statute even though no formal criminal proceedings have been brought against him. To single out Sloan as one of a select group, namely brokers and dealers, and to require him to register with the S.E.C. and to maintain records which may be used to incriminate him in an ill defined area of criminal law results in a clear deprivation of Sloan's constitutional rights. cf. <u>United States</u> v <u>Reeves</u> 425 F. 2d 1063 (10th Cir. 1970); Wigmore on Evidence Vol. 8 §2259c (1975 pocket supplement).

<u>POINT II</u>

<u>THE ORDER OF THE SECURITIES AND EXCHANGE COMMISSION MUST BE VACATED BECAUSE THE PETITIONER WAS DEPRIVED OF HIS FIFTH AMENDMENT RIGHT TO NOTICE AND THE OPPORTUNITY FOR A HEARING AND HIS SIXTH AMENDMENT RIGHT TO BE INFORMED OF THE NATURE AND THE CAUSE OF THE ACCUSATIONS AGAINST HIM.</u>

The order for public proceedings which commenced this case was dated April 25, 1972. On April 28, 1975, three years and three days later, the S.E.C. finally made its decision. However, the decision concerned itself with many events which were not described in the order for public proceedings and which had not even occurred at the time of the administrative hearings in October and November of 1972. Specifically, the decision discusses a trial which took place in December, 1973, a judgment of injunction which was entered in January, 1974,

violations of the bookkeeping and net capital rules which were alleged to have occurred in 1973, a second injunctive proceeding which was commenced in December, 1974, a petition for a writ of mandamus in which the S.E.C. did not appear or participate which was filed in January, 1975, a preliminary injunction which was obtained by the S.E.C. in January, 1975, and a motion for a stay which was addressed to the Court of Appeals in February, 1975. Clearly, Sloan did not know and could not have known that these events would be considered in an administrative proceeding where final briefs were filed in July, 1973.

The order for public proceedings stated that Sloan would be given "an opportunity to establish any defenses to such allegations" as were involved in this administrative proceeding. (A16). Clearly, this was not done. The United States Supreme Court, in Re Ruffalo 390 U.S. 544, 550 (1968), established that a procedure such as this is unconstitutional. That decision, which involved a New York State disbarment proceeding, was applied to an S.E.C. administrative proceeding in Jaffee & Co. v S.E.C. 446 F. 2d. 387, 394 (2d Cir. 1973). That latter decision is directly on point.

It is clear that the S.E.C. placed great weight in its decision of April 28, 1975 on events which it said took place in 1973, 1974 and 1975 from the fact that in the seven line summary of the "Grounds for Remedial Action," five lines were devoted to summorizing these subsequent events. (A51). Moreover, the decision of the S.E.C. emphasizes in footnote that "here we have facts and circumstances before us that were unknown to and could not possibly have been forseen by our staff." This sentence refers obviously to the events which allegedly took place in 1973, 1974 and 1975 and which occurred long after the hearing.

Moreover, even if all of the references in the S.E.C.'s decision to these subsequent events were to be deleted, Sloan still was not accorded notice and the opportunity for a hearing. The order for public proceedings does not provide notice in any meaningful way. The order simply recites the language of

various provisions of the Securities Exchange Act of 1934 and six rules promulgated thereunder and asserts in conclusory terms that these rules have been violated. For example, it says that "Sloan & Company's aggregate indebtedness to all other persons exceeded 2,000 per centum of its net capital." (A15). This does not inform Sloan of what specifically he is accused of doing and is simply a direct quotation from S.E.C. Rule 15c 3-1. As a matter of fact, the 2,000 per cent figure never came up during the hearing.

In an effort to determine what specifically the S.E.C. was accusing Sloan of doing, Sloan's attorney made a motion for a more definite statement. This motion was denied. (A24-26). It is submitted that this decision is clearly erroneous. In civil suits brought in this Circuit, the law is that in an action alleging securities law violations, mere conclusory allegations to the effect that the defendants conduct was in violation of the rules and regulations provided for in the various securities acts are wholly insufficient. Shemtob v Shearson, Hammill & Co. 448 F. 2d 442, 444 (2d Cir. 1971); Segal v Gordon 467 F. 2d 602, 607 (2d Cir. 1972). The same principle is even more true in administrative proceedings such as this one which are quasi-criminal and punitive in nature. It should be remembered that the right to notice and the opportunity for a hearing in civil proceedings is derived from the due process clause of the Fifth Amendment whereas in criminal cases the even more explicite provision of the Sixth Amendment which gives defendants the right "to be informed of the nature and the cause of the accusation" controls. Thus, under the Fifth or the Sixth Amendment or both, Sloan has the right to be told specifically what he is accused of doing. This has not been done here.

It can be seen by reading the original notice (A14-16), the initial decision (A34-48) and the final decision (A51-58) that so little continuity was preserved that Sloan did not know and could not have know what alleged acts would form the basis for the final decision of the S.E.C. and therefore did not have adequate opportunity to present his defenses and to call witnesses in his own behalf. This point becomes even more clear upon examination of the full

record of this proceeding. For example, at a prehearing conference on October 4, 1972, the S.E.C. staff indicated that Sloan's dealings in a new issue would form the basis for the proceeding against Sloan. (R6). In the ensuing colloquy, Sloan's attorney, Taylor, indicated that he had yet to be shown any evidence which tended to show that Sloan had made a transaction in a new issue during the period in question. (R17). In response, the S.E.C. attorney indicated that the facts would be proven at the hearing. (R 17).

At the hearing, however, the S.E.C. said nothing about any alleged transaction by Sloan in a new issue. To this day, Sloan has not been informed even of the name of the new issue in which he supposedly made his transaction and Sloan has no idea of what counsel for the S.E.C. was talking about at the prehearing conference. Yet prior to the hearing, Sloan had to prepare a defense based upon a theory of liability which might be extrapolated from a transaction which Sloan allegedly made in a new issue the name of which Sloan had not been told. The only way Sloan could be expected to do this would be for him to go through his records looking for every new issue in which he had made a transaction over an undetermined period of time and to see if he could find a transaction which was in some way irregular. However, since the S.E.C. ultimately did not identify the name of the new issue nor did it attempt to prove the existance of a transaction by Sloan in that new issue, or in any other issue for that matter, Sloan's efforts in this regard to prepare a defense proved to be a waste of time. Consequently, Sloan in fact appeared at the administrative hearing with no actual knowledge of what specifically he was accused of doing.

At the hearing, the same pattern prevailed. The S.E.C. offered into evidence a total of 61 exhibits (numbered 1, 1A, 2, 3, 4A, 4B, 4C, 5A, etc.) which are enumerated as documents 5-65 in the record of this appeal. To this day, what the S.E.C. was driving at in introducing many of these exhibits remains a mystery. For example, one item in the record is the registration statement of John Allmand Boats, Inc. (R755-1016) which consumes 262 pages of the

record. Although counsel for the S.E.C. asked the administrative law judge to take judicial notice of this document (A339) and asked Sloan several questions concerning this document (R365-366) the S.E.C. has yet to offer a cogent explanation of what the S.E.C. proposes to prove or claims it did prove through this document or what this document is doing in the record. The document, incidently, was not filed by Sloan and was dated March 30, 1972 (R878) or two months after any violation alleged in the order for public proceedings.

The same is true of an affidavit filed by Sloan in a lawsuit against Shearson, Hammill & Co., Inc. (R668-682). Again this affidavit bears a date subsequent to January 31, 1972 and therefore falls outside of the time period in which it is alleged that Sloan violated the net capital rule and other S.E.C. rules. (See A15). In addition, this affidavit was not offered for the purpose of impeaching Sloan's testimony. (See A338, R381-383, A339). Clearly, the affidavit could not have been admitted into evidence for any other purpose and indeed the S.E.C. withdrew its offer of this document into evidence. (A339 and A441). Nevertheless, in its post-hearing proposed findings of fact and conclusions of law and supporting brief, the S.E.C. devoted several pages to a discussion of the significance of the affidavit filed in the Shearson, Hammill & Co. lawsuit (R1043, R1099) and to the John Allmond Boats registration statement (R1043, R1099) even though it was plainly apparent that neither of these documents had any legal significance and that the Shearson, Hammill & Co., Inc. affidavit was not even received in evidence.

This circumstance placed an intolerable burden upon the defense. Sloan's counsel was required to devote considerable attention to replying to the "scandalous" references to the Shearson, Hammill litigation (R1129) and to state that "the total irrelevance of the Shearson, Hammill and J.S. Love evidence (another irrelevant matter) is such as to make any comments by the Division abhorrent to all concepts of fairness and due process......" (R1129). Nevertheless, counsel for the S.E.C. in its reply brief continued to advance the frivolous claim that some legal conclusion could be drawn from the Shearson,

Hammill and John Allmand Boats "evidence" (R1153) and reasserted its claims in the related trial before Judge Ward in December, 1973.

The fact that the S.E.C.'s claims concerning the Shearson, Hammill & Co. litigation and the John Allmand Boats registration statement did not and obviously could not have formed a basis for the final decision of the Commissioner's does not mean that Sloan was not deprived of his due process rights. To the contrary, the fact that the S.E.C. staff advanced these and a great many other frivolous and irrelevant claims most of which clearly could not have survived judicial review demonstrates that throughout this proceeding Sloan has been forced to fight a moving target and has been deprived of his due process rights. It can be seen by a complete reading of the 443 page administrative proceeding transcript and comparing it with the final decision of the Commission that not more than perhaps 30 pages of transcript deal with the evidence and allegations which formed the basis for the final decisions of the Commissioners. In short, the S.E.C.'s theory of prosecution of this case has shifted so many times that Sloan did not and could not have known against what to defend.

For example, the final decision of the Commission states (A53):

> "And our staff generally had to make about two or three requests for each trial balance it obtained from registrant."

This fact was, of course, not alleged in the order for public proceedings. More than that, it was not alleged or included in any one of the S.E.C.'s 73 proposed findings of fact. (See R1026 - 1044). Thus, it is apparent that this fact finding was derived from the Commission's "independent review of the record" which it said it made on the first page of its final decision. (A51 n.2). However, this fact finding, unlike many other Commission fact findings, does find a scintilla of support in the record. Whether this scintilla is sufficient to meet the "substantial evidence" test will be discussed in the next section of this brief. However, the point to note here is that Sloan did not receive notice either before or after the hearing that he was accused of violating federal securities law because Kanoff had to make two or

three requests for every trial balance he received. Since Sloan was not timely notified of this charge, he could not present a defense nor could he offer testimony or legal arguments to refute this charge and hence his due process rights were violated.

Actually, the underlying evidence in support of this charge cannot even be found in the S.E.C.'s direct case. Instead, the testimony came out in Taylor's luckless cross examination of Kanoff (A223), where Kanoff twice said in answers, which were not responsive to the questions asked, that he requested a trial balance approximately two or three times per month. Since this was cross examination, Taylor moved on to the next question after he finally received an answer to the question he was asking, understandably oblivious to the fact that he had just elicited testimony which, more than two years later, would form the basis for an order barring his client for life from being associated with a broker or dealer.

This example should demonstrate that Sloan was not given adequate notice of the charges against him and that he has been aggrieved as a result. Moreover, this is not an isolated example. The S.E.C.'s entire case is based upon charges which are unfounded and have never been explicitely stated. This point will become more abundently clear in the next section of this brief dealing with the fact that findings of the S.E.C. are not supported by substantial evidence. However, here it is appropriate to emphasize the fact here that the record is cluttered with irrelevant material which understandably forced Sloan's counsel to expend his efforts to refuting wholly insubstantial claims.

A reading of the 443 page transcript reveals how the record swelled to its present size of 1,285 pages and became cluttered with so much irrelevant material. One of the many improper tactics employed by counsel for the S.E.C. was to read lengthy passages into the record ostensibly for the purpose of impeaching Sloan's testimony but actually for the purpose of attempting to prove things about Sloan which it could not and did not prove by observing the rules

of evidence. For example, at A-341, the following testimony, in which Sloan was testifying as a witness for the S.E.C., took place:

> "Q. Did Mr. Iny ever enter into a partnership agreement with you, Mr. Sloan?
> A. No.
> Q. Mr. Sloan, I would like to read the following questions and answers that were given -- and I ask you if you were asked these questions and gave these answers on April 26, 1971. Page 20/"

Counsel for the S.E.C. then proceeded to read testimony which consumed the next three pages of the administrative hearing transcript. Nothing in the testimony which was read into the record contradicted in any way what Sloan had said on direct. Nevertheless, at the end of reading this lengthy passage, the attorney for the S.E.C. asked Sloan: "Which of your answers is correct?" (A344, line 10) even though there was quite obviously no conflict between the answers. This pattern was repeated throughout Sloan's testimony as a witness for the S.E.C.

Additional irrelevant material was brought into the record through the testimony of one Joseph Iny ("Iny") which occupied forty pages of the transcript. (R383-422). The S.E.C. never explained what it proposed to prove through Iny's testimony. Iny testified that he had a "wide education in many subjects" (R384) and that he had completed his course work for his doctorate in economics at Harvard University and had gotten his masters but had not completed his thesis. (R384). He testified that he was a registered representative for Granger & Co. and that he had met Sloan at the chess club on 72nd Street in 1969 or 1970. (R385). He testified that he had discussed over the counter stocks, particularly Kaiser Steel in which he had previously invested, with Sloan and that he had become friends with Sloan. (R385). He further testified that he had found Sloan to be "intelligent and quick to see the point" (A347) and that this had led him to discuss forming a partnership with Sloan. However, he also testified that he had never consummated any partnership agreement with Sloan and that he had always felt that Sloan "was too much of a plunger on the short side." (A349). In addition, he testified that at about

this time he "came into a large amount of money, which was disproportionate in regard to the capital of Samuel Sloan, and I thought that if he goes into one of the speculations, it might be my money that is lost." (A352).

There are of course, sound financial considerations which prohibit a man of great wealth such as Mr. Iny from getting involved in a partnership with any stock brokerage firm, large or small. However, the proposed partnership or lack thereof does not seem to form the basis for calling Iny to testify as a witness for the S.E.C. In fact, Iny's testimony proved to be a dud and was not repeated when the S.E.C. tried essentially the same case before Judge Ward in December, 1973. At the same time, although the record does not reveal it, Iny became noticably agitated and was visably shaking during the latter part of his testimony and there were several heated exchanges between him and Sloan's counsel which resulted in much scandalous material being included in the transcript. For example, Iny testified that Sloan threatened Iny (A357) but later testified that Sloan had not threatened Iny but rather had surprised and personally offended him (R414) by stating that any testimony Iny might give would be subject to cross examination by Taylor. (A360).

Predictably, allegations of improprieties by Sloan in his personal dealings with Iny made their way into the S.E.C.'s post hearing proposed findings of fact and conclusions at law (R1034, R1043) and accompanying brief (R1087) regardless of how baseless or unfounded they might be. Of course, if there were any truth to the claim that Sloan threatened Iny in order to keep him from testifying at the administrative hearing, it would be appropriate to refer the matter to the U.S.Attorney for possible criminal prosecution since this is a matter beyond the authority and the competence of the S.E.C. There is no indication that the S.E.C. took this action. What is clear is that the strategy of the S.E.C. was to hurl at Sloan a potpurri of charges of wrongdoing on Sloan's part so as to make it prohibitively difficult for him to provide a detailed response to each charge.

Of course, the claim that Sloan threatened Iny has not survived and most of the other charges leveled at Sloan by the S.E.C. have met a similar fate. But the record makes it clear that as soon as Sloan has succeeded in disproving one charge, another one is made. Indeed, in a brief filed in this appeal in response to Sloan's motion dated March 12, 1976 for leave to adduce additional evidence and for other relief, the S.E.C. advanced yet a new theory of its case when it said on pages 10-11 thereof that "[Kanoff's] statement that Sloan was doing business on particular dates was based primarily on confirmation which he found at Sloan & Co.'s offices." The fact is, however, that neither in the initial decision nor in the final decision is there a finding that Sloan was doing business as established by confirmations. Indeed, a reading of the transcript establishes that no such finding could have been made. On cross, Kanoff testified (A213-214):

"Q. How many confirmations were scattered around the office?
A. Several hundred, I suppose. Some boxed, some packaged, some loose.
Q. Do you have any idea whether they were current or non-current?
A. No.
Q. You did not examine them?
A. Some were even blank.
Q. Did you examine them?
A. I looked at some of the blanks, because they were different brokers confirms."

With this quality of testimony, common sense and the rules of evidence establish that the confirmations which Kanoff testified that he observed prove nothing about whether or not Sloan was doing business.

Of course, the consideration here is not that the S.E.C. is wrong on the evidence on this point but that somewhere along the line the charges by the S.E.C. should be specified so that Sloan can adequately respond to them. There is a real likelyhood that the S.E.C. will do in its brief to this Court what it did in its brief in S.E.C. v Sloan & Co. Docket No. 74-1436 in which Sloan filed a brief which demonstrated that all of Judge Ward's finding of fact were unsupported by the evidence and the S.E.C. filed an answering brief which in effect proposed new findings of fact and impliedly suggested that these new

findings of fact be adopted by the Court of Appeals.

Clearly, this should not be permitted. Again, the decision in Jaffee & Co. v S.E.C., supra 446 F. 2d at 394 is directly on point.

The Supreme Court, in Conley v Gibson 355 U.S. 41, 47 (1957) declared that in civil actions all that is required is "a short and plain statement of the claim that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." It can be readily seen that even under this liberal standard of pleading, the notice provided by the S.E.C. is insufficient. In all civil suits filed in the federal courts, there is a requirement that the complaint be signed and in some cases verified. Fed. R. Civ. P. 11. The pleading in this case was not signed by an attorney as such but rather was signed by the Secretary of the S.E.C. who presumably routinely signs many such documents every day. The pleading starts out with the words:

> "As a result of an investigation, the Division of Trading and Markets has obtained information which tends to show and it alleges that:"

The order never states what person or persons in the Division of Trading and Markets conducted this investigation, what evidence, if any, was uncovered, and who specifically is making the allegations in question. Thus, the notice sets forth little more than whispered rumors by faceless people, cf. United States v Nugent 346 U.S. 1, 13 (1953) (Douglas, J., dissenting) rather than the grounds upon which the pleading rests as required by Conley v Gibson, supra and the United States Constitution. Under these circumstances, in view of the fact that Sloan clearly has not been given adequate notice and the opportunity for a hearing, the order of the S.E.C. must be set aside.

POINT III

THE FINDINGS OF THE SECURITIES AND EXCHANGE COMMISSION ARE NOT SUPPORTED BY SUBSTANTIAL EVIDENCE.

The foregoing section of this brief has already demonstrated that the S.E.C. has continuously shifted its theory of prosecution of this case. However, it would appear that, after three years of struggle and delay, the S.E.C. has settled on a decision. Yet, the decision itself is remarkable. To begin with, it is only eight pages long and only three of these pages are devoted to a discussion of the evidence elicited at the administrative hearing. (A52-54). Thus, this appears to be a case similar to that of the proverbial elephant which after long and prodigious labor, produced a mouse. Under these circumstances, it is even more remarkable that the scanty fact findings of the S.E.C. are not supported by substantial evidence.

A few observations should first be made about the S.E.C.'s presentation of its case. The description found in the first two paragraphs of Judge Mac Mahon's recent decision in S.E.C. v Commonwealth Securities, Inc. CCH Fed. Sec. Law Rep. ¶95,495 (S.D.N.Y. March 30, 1976) could in many respects well be a description of the S.E.C.'s presentation here. In the case at the bar, to borrow Judge Mac Mahon's wording, the "presentation of the case...was confused, disjointed, unfocused, incoherent, and, at times, incomprehensible." Moreover, as Sloan's counsel, Taylor, appropriately noted in his answering brief (R1120-1121):

> "A disturbing feature of the Division's presentation in its proposed findings of fact is an inclination to misstate the evidence by arguing in a rather panoramic fashion and then citing the official transcript of the hearing as if such arguments were in fact part of the record.
>
> For example, on page 4, part 111, paragraph 6 the Division states that Bruder's assignment was for the purpose of checking the books and records of Sloan to see if they were being maintained on a current basis and cites Tr. 21 as the reference.
>
> No such testimony from Bruder exists on Tr. 21."
>
> With respect to the above, the Division's burden of proof requires them to prove the existance of the horse before trying to hitch up the cart, and under the Administrative Procedure Act, the burden of proof is on the Division. See 5 U.S.C. sec. 556(d) which states, in pertinent part:
>
> 'Except as otherwise provided by statute, the proponent of a rule or order, has the burden of proof.'
>
> What is required is substantial evidence, and not merely language written into proposals of fact or briefs containing citations to testimony, which in fact, never took place. (See NLRB v Columbia Enameling & Stamping Co. 306 U.S. 292 (1939)).

> This type of reporting only tends to obfuscate a complex record and makes it more complex for the trier of the facts to complete his task.
>
> It is hoped that the misrepresentation of the record contained in the Divisions proposed findings of fact are inadvertent. I note, however, that this error appears repeatedly."

Those words were written more than three years ago and yet to this day, protestations to the contrary, the S.E.C. continues repeatedly to misstate the evidence. For example, the decision of the S.E.C. says (A52):

> "Stating that the inspection showed that the respondent's records did not comply with our requirements and afforded no basis for establishing his financial position, our staff asked Sloan to produce a trial balance and other data. He furnished something. But no capital computation could be made from what he submitted."

This statement refers to a letter (R473) which asked Sloan to produce at Sloan's office on January 15, 1971 a variety of records including a trial balance. This letter did not ask Sloan to submit anything to the S.E.C. It merely asked Sloan to produce his records for inspection at his office. There is nothing in the evidence which indicates that this was not done. (See A106). To the contrary, the S.E.C.'s proposed findings of fact states that Bruder, the S.E.C. staff investigator, had the opportunity to and did examine the books and records of Sloan & Co. on January 15, 1971. (R1029, ¶7).

It should be noted that the records which the letter asked Sloan to produce were voluminous and encompassed every record a broker dealer is required to maintain.

On direct examination, Bruder testified that he received from Sloan a trial balance as of January 14, 1971. (A67). Already it can be seen that the Commission's findings of fact are completely contrary to the testimony of the S.E.C.'s own investigator on direct examination. Thus, the decision should at least be amended to read "He furnished a trial balance as of January 14, 1971" where it now says: "He furnished something." Of course, on cross examination, in a portion of the transcript which the S.E.C. chose to include in the supplemental appendix (R86), Bruder testified that Sloan never submitted any infor-

mation whatever. This testimony had Rashes, the attorney for the S.E.C., on his feet objecting to the question. Obviously, Rashes knew that Bruder had just contradicted his prior testimony and, moreover, and not told the truth. The fact is that on Monday, January 18, 1971 Sloan produced all of his financial records at the offices of the S.E.C. and Rashes, the attorney, personally examined them. This fact, however, is not clear from the confused and often self-contradictory testimony of Bruder.

The pertinent testimony here on cross is as follows: (R86)

> "I ask you,did Mr. Sloan submit that information?
> A. No.
> Q. To your knowledge?
> A. No.
> Q. He never did?
> A. He did not.
> Q. Well, let that stand.
> Mr. Rashes: I don't think that question is proper, your Honor.
> He said he never did.
> I think we should get ourselves to some specific dates, whether he submitted it by such and such a date.
> It is not an infinity type letter.
> Mr. Taylor: I object very strenuously to the staff counsel interrupting the witness to lead him in his answers.
> I think it should completely destroy the credibility of the witness, if he persists in this.

This colloquy makes it clear that Bruder was in conflict with his own prior testimony, that Rashes well knew that this was the case, and that Rashes objected to a proper question in order to tell Bruder how to respond to the questions propounded by Taylor.

At another point in the same cross examination, when Rashes did essentially the same thing, Taylor stated (A112-113):

> "Mr. Taylor: I raise in direct anger at this type of explanation, because he has again told the witness how to make his testimony."

At this point it should be noted that the rules of evidence were dispensed with in this proceeding to an extent which gave the S.E.C. an overwhelming advantage. To be sure, it is been held that the rules of practice in the courts do not govern or control the admissibility of hearsay evidence in administra-

tive proceedings before certain agencies such as the NLRB "so long as the evidence upon which the decision is ultimately based is both substantial and has probative value." Jacobowitz v United States 424 F. 2d 555, 559 (Court of Claims, 1970). At the same time, the rules of evidence are there for a reason and dispensing with the rules altogether, as the S.E.C. administrative law judge did here, cannot be justified. It should be noted that under the rules of evidence, none of the net capital computations prepared by the S.E.C.'s staff, which formed the basis for the allegation that Sloan had violated the net capital rule, would be admissible. Here, even assuming they were properly admitted, the S.E.C. still must demonstrate that they have probative value, i.e., that the computations are correct. This, the S.E.C. utterly failed to do and indeed has made no attempt to do.

A

THE ADMINISTRATIVE LAW JUDGE IMPROPERLY RECEIVED HEARSAY EVIDENCE, PERMITTED LEADING QUESTIONS AND ALLOWED VIOLATIONS OF THE RULES OF EVIDENCE IN OTHER RESPECTS AND, AS A RESULT, THE PETITIONER WAS DEPRIVED OF HIS CONSTITUTIONAL RIGHT TO DUE PROCESS OF LAW.

In Jacobowitz v United States, supra the Court of Claims rendered a comprehensive decision on the question of precisely when and under what circumstances hearsay is admissible in administrative proceedings brough by various agencies of the United States. This decision which cites copious authorities merits careful study. There, the court said:

> "It is academic, of course, that the governing regulations of the administrative agency involved, and applicable statutes must be applied and enforced in any given case in considering the admission or rejection of hearsay evidence." 424 F. 2d at 559.

However, that decision, although citing numerous authorities involving the NLRB, the IRS and other administrative agencies, does not cite any cases involving proceedings before the S.E.C. The apparent reason for this is that the S.E.C. has not promulgated any "governing regulations" which permit the admission of hearsay evidence at administrative hearings before the S.E.C.

Every Supreme Court and lower court decision which has held that hearsay is admissible in an agency proceeding has based its decision upon a specific rule or statute. In the case at the bar, there being no governing rule or statute, the Federal Rules of Evidence must be applied. Moreover, even assuming arguendo that there were a governing regulation which permitted the admission of hearsay, there would still be a question of whether the S.E.C. does not deprive a respondent such as Sloan of his constitutional due process rights by bringing an administrative proceeding such as this one where evidence which would clearly not be admissible against Sloan in a court of law can be used. It should be remembered that in this case the S.E.C. started a lawsuit on June 17, 1971 entitled S.E.C. v Sloan & Co. 71 Civil 2695 but nearly a year later started this parallel administrative proceeding which it then elected to prosecute first while allowing the court proceeding to lay dormant. It seems obvious in view of the evidence presented here that the S.E.C. feared adverse evidentiary rulings which would have foreclosed any attempt it might have made to prevail after a court trial and felt that it had a better chance of prevailing in its own agency proceeding before its own administrative law judge who had been an employee of the S.E.C. for many years. It is submitted that clearly, in this case, Sloan has been deprived of his due process rights and hence the order of the S.E.C. must be set aside.

Early in the administrative hearing, the administrative law judge declared that "hearsay is admissible." (A111). To this, Sloan's counsel objected, stating that hearsay is not to be substituted for direct evidence. It can be seen that almost the entire presentation of the S.E.C.'s case was based upon hearsay in circumstances where direct evidence could readily have been obtained if the allegations of the S.E.C. were true. For example, both Bruder and Kanoff testified that they knew that Sloan was doing business because they overheard telephone conversations. (A86, A110-114, A194, A237-241). This testimony was clearly hearsay. However, the fact that Sloan did business could not have reasonably been established by the fact that Sloan had telephone conversations.

Many persons who do not engage in a general securities business nevertheless discuss the stock market over the telephone. The best way to establish that Sloan did business in securities on specific dates would have been to subpoena Sloan's actual books and records. However, the S.E.C. failed to do this in spite of the fact that the S.E.C., unlike some other administrative agencies, has subpoena power. Significantly, it has been held that the best evidence rule applies in proceedings even before agencies where hearsay is admissible. Willapoint Oysters Inc. v Ewing 174 F. 2d 676, 691 (9th Cir. 1949) cert. denied 338 U.S. 860 (1949).

The bulk of the evidence presented by the S.E.C. in this case consists of computations which are often illegible and which are supposedly based upon figures extracted from Sloan's books. Clearly, such computations are not admissible in court proceedings particularly where as here the underlying source documents, namely Sloan's books, are not offered into evidence or otherwise produced. Again, the S.E.C. possessed subpoena power and could have produced Sloan's books but elected not to do so.

In addition, the computations submitted by the S.E.C. were supposedly based upon security prices obtained from the pink sheets and the Wall Street Journal. Under the best evidence rule, the S.E.C. was required to produce the pink sheets and the Wall Street Journal in order to support the nearly one thousand separate computations of security prices made by Bruder and Kanoff upon which the claims that Sloan violated the S.E.C.'s net capital rule on eleven separate dated (A53 n.11) depends. It should be noted that with with regard to hearsay and other evidentiary rulings, Sloan's counsel, Taylor, protested vigorously both at the hearing and in his post-hearing brief and his objections were almost invariably overruled. (For the single exception, see A172-173. However, on that occasion the attorney for the S.E.C. did not object to the exclusion of the evidence.)

Moreover, at the hearing, the administrative law judge allowed violations of the rules of evidence on a grand scale by permitting counsel for the S.E.C. to ask leading questions on direct examination. Apparently, the administrative law judge felt that no rules of evidence need be observed in administrative proceedings. It can be readily seen that most of the direct testimony of the S.E.C. investigators came in response to leading questions. A typical series of questions and answers on direct examination was as follows (A139 - 140):

"Q. During this June 9th visit, did you have any conversations with Mr. Sloan?
Strike that.
During this June 9th visit, did you request of Mr. Sloan a trial balance?
A. Yes.
Q. Did Mr. Sloan produce a trial balance to you at that time, for the end of May?
A. No, sir.
Q. Did you ever receive a trial balance from Mr. Sloan for the end of May?
A. No, sir.
Q. Did you ever receive any financial reports of Sloan & Co. for the end of June, 1971?
A. Yes, I did.

These were all leading questions which clearly could not have been asked on a direct examination at a trial and should not have been permitted here. This particular passage is noteworthy in that Rashes started to ask Kanoff a proper question and then said "strike that" and asked an improper question. Moreover, what happened on the date of June 9, 1971 has been the subject of dispute since Sloan filed a special supplemental affidavit in federal court dated November, 1973 in S.E.C. v Sloan & Co. 71 Civil 2695 which stated that on the occasion in question Kanoff had asked Sloan for the March, 1971 and not for the May, 1971 trial balance. However, a careful reading of the questions and answers just cited reveals that Kanoff did not testify that he requested from Sloan specifically a May, 1971 trial balance on June 9, 1971.

Sloan's counsel did not sit idly while the S.E.C. attorney asked leading question after leading question. Rather, he objected repeatedly and on each occasion his objection was overruled. For him to have objected more strenuously

would have been for him to insult the administrative law judge. Almost as soon as the hearing commenced, the administrative law judge stated: "we allow a certain amount of leading." (A68). It soon became evident, however, that "a certain amount of leading" was much indeed. Taylor continuously objected to leading questions and to the fact that the S.E.C. attorney was telling his witnesses the answers. (A71, A75, A77, A87, A129, A195, A263-264, A274-275). A particularly egregious example of how far the administrative law judge was willing to go in permitting leading questions by the S.E.C. attorney is provided by the colloquy found at A274-275. It should be clear from his ruling there that any question propounded by the attorney for the S.E.C., regardless of how improper or leading it might be, would be allowed by the administrative law judge. It is equally clear that it was not necessary for Taylor to object to every leading question propounded by the S.E.C. attorney in order to preserve the objection for appeal particularly in view of the number of times Taylor did object and the fact that his objection was overruled on every occasion. The extensive reliance by counsel for the S.E.C. upon leading questions on direct examination was unfair and prejudicial to Sloan's rights and on this ground alone the decision and order appealed from should be set aside.

Although it has sometimes been held that the technical rules involving hearsay evidence need not be observed at administrative hearings it has never been held that leading questions are permissible particularly in a case such as this one where the person being examined was an employee of the government and the government's counsel clearly had the opportunity to interview at leisure in order to prepare the government's case for the hearing.

<u>B</u>

<u>THE FINDINGS OF THE SECURITIES AND EXCHANGE COMMISSION THAT THE PETITIONER WILFULLY VIOLATED THE RECORDKEEPING RULES ARE NOT SUPPORTED BY SUBSTANTIAL EVIDENCE AND ARE CONTRARY TO THE PROPONDERENCE OF THE EVIDENCE.</u>

The fact that the S.E.C. obtained a tremendous advantage because of the

improper evidentiary rulings by the S.E.C. administrative law judge makes it even more remarkable that the S.E.C. displayed the inability to put together a case against Sloan supported by substantial evidence. The characterization of the S.E.C.'s case in Klopp v S.E.C. 427 F. 2d 455, 457 (6th Cir. 1970) where said "this case borders on fantasy" could well be said of the S.E.C.'s presentation here. Bruder's testimony was so confused and disjointed that it is unbelievable that a government agency could seriously maintain that anything was proven by this testimony. For example, as noted previously, Bruder testified that he received from Sloan a trial balance dated January 14, 1971. (A67). According to the record, this document was marked Exhibit 3. (A68). However, Exhibit 3 on its face shows a date of January 18, 1971. (R475). If this were the only instance of a discrepancy such as this, it could well be overlooked. However, this is not the only instance and most of Bruder's babbelings while he was on the witness stand can fairly be characterized as incomprehensible. Here it must be said that counsel for the S.E.C. did nothing to clarify matters and instead added to the confusion. This led to numerous erroneous fact findings by the Commission.

For example, the final decision says that "a subsequent examination was made on February 25." (A53). An examination of the record, however, fails to establish that an examination was made on February 25, 1971. Instead, February 25, 1971 was a date on which Bruder testified that he received a document in his office. (A78). Bruder expressly testified that he did not recall the date in February on which he visited Sloan's office. (A76). However, Rashes succeeded in putting words into Bruder's mouth as follows (A86):

> Q. What were the condition of the books and records on February 25, 1971?
>
> A. On February 25, 1971 they still weren't quite clear.

Bruder had previously testified that he could not recall the date and this is the only time Bruder on direct examination referred to the date of February 25, 1971 as being the date of a visit to Sloan's office. Clearly, then, the finding that Bruder visited Sloan's office on February 25, 1971 is not supported by substantial evidence. Indeed, it seems improbable that Bruder actually

visited Sloan's office on that date because, if he visited Sloan's office on February 25, 1971, why would he take off a trial balance as of January 29, 1971.

It does, however, appear that Bruder visited Sloan's office on some date in February, 1971.[3] The question, then, is what did Bruder find on the occasion of this visit. Bruder himself stated that he was confused on this point. (A123-124). Notwithstanding Bruder's confessed confusion, the S.E.C. makes a finding that on that date Bruder's examination "disclosed that the stock record and customers ledger were not up-to-date, and that the income and expense account was not properly maintained." (A53). The entire direct testimony on which the S.E.C. presumably relies for this finding was as follows. (A86):

> "There were a number of mistakes. The capital was not properly recorded, and the stock record wasn't up to date; neither was customer's ledger, as I recall.
>
> Q. What, if anything, did you find in relation to the income and expense account of Sloan & Co?
>
> MR. TAYLOR: Objection to the form, your Honor.
>
> JUDGE TRACY: Would you refine the question?
>
> MR. RASHES: I asked what,if anything. I don't believe it is a leading question.
>
> MR. TAYLOR: He told him the answer by implication of the question.
>
> JUDGE TRACY: I don't understand the question.
>
> Q. Did you examine the income and expense account of Samuel H. Sloan and Co.
> A. I did.

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3. Probably Bruder actually visited Sloan's office on or about February 1, 1971. Whenever it was that Bruder made his February visit, he obtained a deposit slip from Sloan dated January 29, 1971. In addition, during the first days of February, 1971, Bruder wrote a letter to Sloan's mother and apparently delayed computing Sloan's net capital while awaiting a response. (A109). These facts are consistant with the conclusion that Bruder visited Sloan's office on or about February 1, 1971 and waited twenty-five days before computing Sloan's net capital which he did in the offices of the S.E.C. without the necessity of a return visit to see Sloan again. Had the administrative law judge not erroneously denied Taylor's request to examine the S.E.C.'s non-public files (A143), the answers to questions such as this could be easily ascertained.

Q. What was the result of that examination, Mr. Bruder?
A. It wasn't properly maintained.
Q. Mr. Bruder, when did you retire from the Commission?
A. In April, 1971.

MR. RASHES: No further questions, your honor."

It is difficult to believe that the S.E.C. could contend that this colloquy constitutes "substantial evidence" which proves that Sloan violated federal securities laws. Yet, this colloquy is the only evidence presented in the S.E.C.'s direct case which supports the findings of the second sentence of page three of the S.E.C.'s decision. (A53). It must be remembered that the United States Supreme Court has said that "substantial evidence is more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." <u>Universal Camera Corp.</u> v <u>NLRB</u> 340 U.S. 474, 477 (1951). Yet,Bruder here offers his conclusion, i.e., that the income and expense account was not properly maintained, without providing any testimony as to what evidence leads him to that conclusion.

Moreover, on cross, Bruder repudiated even this scanty testimony. After Taylor read from the document which the S.E.C. seems to contend that Bruder prepared on February 25, 1971, Bruder testified that the stock record of Sloan & Co. was correct and that he verified it to be correct. (A110). This was a contradiction of Bruders statement on direct examination that Sloan's stock record was not up-to-date.

This was not only the only time where Bruder testified one way on direct examination and testified to the contrary on cross. The S.E.C. appears to base its findings in the first sentence of the third paragraph of the second page of its decision upon Bruder's testimony at A64-65. At this point, Bruder was reading from a note which, in an error under the Federal Rules of Evidence, the administrative law judge refused to mark (A63) and consequently is not available to this Court. On cross, apparently testifying without the benefit of his notes, Bruder contradicted his previous testimony as follows (A95-97):

"Did you examine to see if Sloan & Co. maintained a blotter records of purchases and sales of securities?

A. Yes, I did.
Q. Did you find that he had such records?
A. He did.
Q. Did you find or did you examine to see if he had a stock record?
A. Yes.
Q. And did you find that the stock record was present? That he did maintain it?
A. On the initial visit, the stock record was not maintained currently.
Q. How many days was it behind then? In postings that is.
A. I don't recall at this time.
Q. But there was a stock record maintained.
A. Yes.
Q. As of some date?
A. As of a certain date?
Q. Did you examine to see if he had a record of the securities fail to deliver and fail to receive that were opened on the date of your examination?
A. Yes.
Q. Was there a record?
A. There was.
Q. Did you examine to see if he had a record of trading account positions, long and short, at the date of your examination?
A. Yes.
Q. Was there such a record?
A. Yes.
Q. Did you examination to see if he had maintained a customer ledger at the date of your examination?
A. Yes.
Q. Was there such a record?
A. Yes."

From this testimony, which is the testimony of the S.E.C.'s own investigator, it is apparent that Sloan maintained voluminous records. Several other things are apparent from this testimony as well. For one, the S.E.C.'s "order for public proceeding" (A14-16) should be stricken as false and a sham. Fed. R. Civ. P. 11. This order alleges that "Sloan & Co. has failed to .... maintain certain of its books and records including....(1) ledgers..(2) a securities record or ledger...(3) ledgers (or other records) reflecting securities failed to receive and deliver"....... Clearly, Sloan maintained all of the records specified in the order. Thus the allegations contained in the S.E.C.'s initial notice were untrue and the S.E.C.'s staff counsel well knew or should have known them to be untrue.

Moreover, it should be apparent that if there were violations of the record keeping rules, which violations have yet to be proven, these violations were not wilful and hence Sloan cannot be punished. However, the most important point here is that the findings of the S.E.C. are not supported by substantial evidence and instead are contradicted by the testimony of the S.E.C.'s own investigator.

Going through the S.E.C.'s decision sentence by sentence and clause by clause and demonstrating that each sentence and clause is not supported by substantial evidence is a laborious and burdensome task especially since the S.E.C. staff itself has never been required nor has it attempted to marshall the evidence and relate it to the legal contentions of the parties. This is particularly true in this case because the S.E.C. rejected the proposed findings of fact prepared by its own staff and the initial decision of its administrative law judge as well and wrote a decision based upon an "independent review of the record." (A51 n.2). For this reason, it cannot be readily determined what specific pages of the 1,285 page record the S.E.C. is relying upon in making its findings of fact. The problem is further compounded because the findings of fact here are not set forth in paragraphs numbered or otherwise in such a way as to spell out what specifically the S.E.C. believes that Sloan did which violated precisely which section of which S.E.C. rule.

The initial page of the S.E.C.'s decision ostensibly deals with background. However, already in footnote one the S.E.C. launches into a discussion unsupported by testimony or evidence in the record. However, it does not appear that the S.E.C. is using the statements made in footnote one of its decision as a basis for concluding that Sloan and Sloan & Co. have violated federal securities laws.

The background discussion continues in the first paragraph of the second page of the S.E.C.'s decision. Although the material in this paragraph does not seem to purport to make fact findings, it should be stated that the decision is technically incorrect when it refers to "specific violations." The complaint

in the court action, S.E.C. v Sloan & Co. 71 Civil 2695, did not allege any specific violations but rather set forth in conclusory terms charges of wrongdoing similar to the charges in the "order for public proceedings" here. However, when the case came to trial the S.E.C. submitted to Judge Ward proposed findings of fact and conclusions of law which were copied verbatum from the proposed findings of fact and conclusions of law submitted here with the only difference being that the S.E.C. included additional charges related to events in 1973 which allegedly occurred after the date of the administrative hearing here but prior to the trial before Judge Ward. It would seem that the S.E.C. submitted identical proposed findings of fact and conclusions of law in the two cases in the hope of obtaining uniform decisions from Judge Ward and the S.E.C. Submitting identical proposed findings of fact and conclusions of law also saved the S.E.C. and Judge Ward as well considerable time and effort. As it turned out, Judge Ward virtually copied the S.E.C.'s proposed findings of fact and conclusions of law in writing his decision reported at 369 F. Supp. 996 (1974) even though there was no evidence in the record of the trial before Judge Ward proving most if not all the facts found in Judge Ward's decision. This point was discussed in detail in the appellants brief in S.E.C. v Sloan & Co. 74-1436. As noted previously, the S.E.C.'s answering brief did not attempt to defend Judge Ward's specific fact findings but instead essentially proposed new fact findings to the appellate court.

Returning to the S.E.C.'s decision here, the first paragraph under the heading "Recordkeeping violations" (A52) appears to be an attempt to summarize the paragraphs which follow. Other than stating that a "broker dealer inspection.... revealed various infractions," without stating what those infractions were, this paragraph does not appear to purport to make findings of violations of S.E.C. rules. The next paragraph, however, does claim to set forth specific violations of the S.E.C. recordkeeping rules and accordingly a detailed discussion of this paragraph is in order.

The first clause states that the "initial inspection disclosed.... that

capital, income and expense accounts were not properly recorded in registrants general ledger....."

The only **direct testimony** examination concerning this initial examination is found at A64-65. There Bruder, who was reading from a note (A63), testified:

> "The general ledger disclosing assets, liabilities, income and expenses and capital accounts were not maintained."

This was Bruder's only testimony concerning the general ledger. Bruder quite simply testified that Sloan did not have a general ledger. Accordingly, the S.E.C.'s fact finding that certain items were not properly recorded in Sloan's general ledger is clearly erroneous as the S.E.C.'s own investigator testified that Sloan had no general ledger.

However, on cross examination, Bruder changed his mind and decided that Sloan had a general ledger after all. Here is how Bruder testified starting at A51:

> "When you examined on January 12, 1971 the records of Sloan & Co., you said that they did not have a general ledger, is that correct?
>
> A. I said the general ledger, I believe, was not properly maintained.
> Q. What did you mean by that?
> A. Well the income and expense of the general ledger was not properly maintained. Capital was not properly recorded.
> Q. In what regard, Sir?
> Specifically tell me what was not maintained.
> A. Particularly the capital account was not properly maintained.
> Q. You keep saying not properly maintained, and I want you to tell me what was not properly maintained of that ledger account.
> A. There wasn't a true record of Sloan's capital there."

Following this lack of an answer, Taylor continued to press Bruder for specific details concerning Sloan's capital account. Bruder never provided a cogent explanation of what was wrong with Sloan's capital account. After an objection by the S.E.C. and further colloquy, the cross examination got back on course as follows. (A53):

"Q. Did you say, Mr. Bruder, that there was no general ledger maintained by Sloan & Co.?
A. I said the general ledger was not properly maintained.
Q. I ask you again, how was it improperly maintained then?
A. I explained that the capital account was not properly maintained.
Entries for certain capital were not put in there, also income and expense was not properly recorded there.
Q. How was the income and expense improperly recorded?
A. There were missing items.
Q. Such as?
A. Certain items of commissions, I would say.
Q. What specifically were the commissions omitted?
A. Well, Mr. Sloan had a rather -- rather, Sloan & Co. had executed an agency transaction. There were certain commissions that were omitted or in the book. I can't recall at this time.
Q. Do you know, if your testimony is, sir, that the records were improperly maintained because of this, I ask you what commission was not recorded on what agency transaction?
A. That, Mr. Taylor, is a very hard question. I can't answer that.
Q. You don't know, fine, okay.
That is the response."

It is clear that this evidence, such as it is, is not substantial. First Bruder testified that Sloan did not have a general ledger. Then, apparently forgetting his prior testimony, Bruder testified that he had testified that Sloan did have a general ledger but that it was not properly maintained. When pressed for specific details Bruder repeatedly prevaricated and evaded the questions until he first qualified his answer about Sloan's capital account with the words "if I recall" (A94, line 2) and then finally twice stated "I can't recall at this time" and "I can't answer that." (A95).

It is significant that in his two page redirect examination (A128-129), Rashes made no effort to reopen the subject. It is also significant that Rashes seemed to know that his witness had no present recollection of the events in question. In explaining why it was necessary for his witness to be able to read from notes Rashes stated:

> "MR. RASHES: In this case, your Honor, as you well know, the order is very all-encompassing.
>
> It involves many dates, many visits and many trial balances.
> I believe the witnesses are going to have to use notes to refresh their recollection, as it involves over a year's time and many, many years."

However, since Kanoff testified primarily without the benefit of notes, it is clear that Rashes' concern was with Bruder and from reading Bruder's testimony it is clear that Rashes had good reason to be concerned. Bruder's testimony could well be cited as a classic example of the testimony of a witness who has lost any recollection he may once have had of what he observed and is groping for plausible answers in order to avoid having to confess his own personal inadequacies. It is clear that Bruder is proud of his thirty (30) years on Wall Street[4] (A88) in spite of the fact that he frequently changed jobs. (A89). It is also clear that he considers himself to be something of an authority on the way that stock brokers are supposed to keep books. He gave testimony, which is incredible, that in the case of every broker for whom he worked, the books and records were "kept exactly the same way." (A89). Thus, when Bruder testified that Sloan's books and records were "not properly maintained" it seems plausible that he really meant that Sloan did not keep books and records the same way as did his employers of thirty years ago. Bruder also testified that during his twelve years with the S.E.C., he examined the records of "perhaps 50" brokerage firms all of whom maintained their records the same way although "each had its slight variations." (A90). Presumably, inspecting the records of brokers and dealers was not Bruder's primary job since performing an average of four inspections per year would not be likely to keep him busy.

It should be pointed out here that nothing in the record indicates that Bruder had any qualifications for his job other than his 30 years of working on Wall Street for a total of twelve or thirteen brokerage firms. (A89). It cannot be determined from the record that Bruder even graduated from high school. Bruder testified that he started as a runner (A88) but, unlike Gustave Levy of Goldman, Sachs & Co., he did not work his way up to being the head of a major brokerage firm. Instead, Bruder appears to have continued to be a runner as

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4. Bruder died in 1974 but the word "is" is used for stylistic reasons.

well as performing various other tasks throughout his years in Wall Street. (A88). This is not to say that there is anything dishonorable about the profession of being a runner. However, the question before this court is whether the testimony of such a man who expresses his personal opinion that Sloan's books and records "were not properly maintained" should be sufficient to bar Sloan for the rest of his life from being associated with a broker or dealer. It is submitted that the answer to this question is obvious.

Turning to the next clause of the S.E.C.'s fact findings which are based upon Bruder's testimony, it says: "the stock record was not kept current." Bruder actually testified: "Stock record was in the preparation of being brought into compliance, but was not completed." (A65)

Again, the S.E.C. in its decision does not appear to have relied on this testimony elicited on direct examination but instead to have copied, in it decision, when what Bruder said on cross. There, in a passage quoted previously, Bruder said (A96):

"Q. Did you find or did you examine to see if he had a stock record?
A. Yes.
Q. And did you find that the stock record was present? That he did maintain it?
A. On the initial visit the stock record was not maintained currently.
Q. How many days was it behind then? In postings, that is.
A. I don't recall at this time.
Q. But there was a stock record maintained?
A. Yes.
Q. As of a certain date?
A. As of a certain date."

Again Bruder resorted to the classic answer: "I don't recall at this time." This answer negates any value Bruder's testimony concerning the stock record might otherwise have. It is plainly apparent that if Bruder had any present recollection of the fact that Sloan's stock record was not up-to-date he would be able to remember at least approximately how far behind Sloan's stock record was. Actually, a few pages later Bruder revealed that the reason he did not

know how far behind was Sloan's stock record, was that he did not examine Sloan's stock record. There, Bruder testified (A105):

> "Did you look to the stock record of Sloan?
> A. No, I did not.
> Q. Was there any reason why you did not.
> A. At this time, or rather at that time, I figured that the trial balance was inaccurate, that I had obtained from Sloan's books and records, there was no sense in checking it at that time."

By now, it should be apparent why at an earlier point in this brief, it was asserted that it is "unbelievable" that the S.E.C. could make fact findings based upon this testimony.

The last two clauses of the sentence in the S.E.C.'s decision now being discussed state:

> "...that there was no account record of bank balances; and that no trial balance had been prepared."

Again this finding is not supported by substantial evidence. The only time Bruder testified about bank balances was as follows (A64):

> "No account record of bank balances, no account records of income and expenses."

However, on cross, Bruder clearly stated that Sloan did have a record of income and expenses but said that it "was not properly maintained." (A92). Bruder then narrowed it further by stating that it was the income, rather than the expense account, which was not properly maintained. (A95 line 8). Finally, Bruder narrowed it down to the commission income account and beyond that he could not recall. Apparently, on cross examination, Bruder forgot what he had said about bank balances on direct examination. It is clear that Sloan's general ledger account of assets and liabilities, with which Bruder found no fault on cross examination (A94-95), would include a record of Sloan's bank balance and common sense dictates that Sloan's check book would also show Sloan's bank balance. There is no requirement in either S.E.C. Rule 17a-3, 17 C.F.R. 240.17a-3, or in S.E.C. Rule 17a-4, 17 C.F.R. 240.17a-4, that a separate record of bank balances be maintained. It should also be pointed

out that the trial balance which Bruder testified that he extracted from Sloan's records indicated that Sloan had $5,716.98 in the bank. (R480). This clearly conflicts with Bruder's testimony that Sloan had no account record of bank balances.

The same basic point applies to Bruders statement that Sloan had no trial balances. Again, by the time of this cross examination, Bruder apparently forgot what he said on direct examination about trial balances. Moreover, Bruder testified that Sloan's gave him a trial balance as of January 14, 1971 (A67) and S.E.C. Rule 17a-3(a)(11), 17 C.F.R. 240.17a-3(a)(11), specifies that trial balances need not be prepared more often than once a month.

The next three sentences of the S.E.C.'s decision have been discussed in the section of this brief dealing with the failure of the S.E.C. to give adequate notice. Again it is apparent that the findings are not supported by substantial evidence. The first of these three sentences says in part that "our staff asked Sloan to produce a trial balance and other data." However, in spite of what the sentence implies, there is no testimony that there was any oral request to produce the materials in question. Rather, the request came in the form of a letter dated January 14, 1971 (R473-474) and the S.E.C.'s own proposed findings of fact (R1029 ¶7) and everything else in the record indicates that Sloan complied fully with this request.

The next sentence in the S.E.C.'s decision states: "He submitted something." (A53). This is clearly erroneous. As has been noted several times, Bruder testified that Sloan submitted a trial balance as of January 14, 1971. (A67).

The next sentence of the S.E.C.'s decision states: "But no capital computation could be made from what he submitted." (A52). A brief discussion is required of this sentence.

In response to a leading question, typical of the entire direct examination of the two S.E.C. investigators, the following colloquy took place (A70):

"A. I couldn't make a true capital computation on that.
Q. Thank you.

MR. TAYLOR: What was that response?
THE WITNESS: I could not make a true capital computation.
MR. RASHES: Mr. Taylor will have ample opportunity on cross examination to bring out any alleged contradiction or any inconsistencies in Mr. Bruder's testimony, and I believe this is just time-consuming and irrelevant.
MR. TAYLOR: That may be, but if the form of the question is improper and they are leading the witness and he responds with an inflamatory remark, it should be objected to at that time.
JUDGE TRACY: Upon receipt of that information from Mr. Sloan, were you able to make a capital computation?
THE WITNESS: No."

That was the only testimony on direct examination regarding the matter of Bruder's alleged inability to make a capital computation. Clearly, this evidence was not substantial.

On cross examination,, Bruder's testimony indicated that in order to prepare a capital computation he needed to examine Sloan's ledger of securities failed to deliver and failed to receive as well as his ledger of trading positions long and short. (A125). Bruder also testified that he promptly proceeded to Sloan's office and experienced no difficulty in making his capital computation. (A126). This fact, however, is left out of the S.E.C.'s decision. It simply states that "no capital computation could be made from what he submitted " implying a violation of S.E.C. rules and then skips to the events of February 25, 1971, more than a month later, thereby leaving out the fact Bruder visited Sloan's office on January 25, 1971 (A72-74) and spent six hours in Sloan's office (R87) apparently without finding any violations of the S.E.C.'s record keeping rules.

This completes the discussion of the first of the three pages of the S.E.C.'s decision regarding alleged violations by Sloan of the S.E.C. record keeping and net capital rules. Before going further it should again be emphasized that the obvious inadequacies in the decision place an unfair burden upon the petitioner. This type of sentence by sentence and word by word analysis is necessary because the S.E.C. will undoubtedly argue that if the

petitioner fails to contest every alleged violation of S.E.C. rules, the decision of the S.E.C. must be affirmed. Such an assertion would be consistent with the arguments advanced by the S.E.C. in S.E.C. v Sloan & Co. Docket No. 74-1436 and S.E.C. v Sloan Docket No. 75-7056.

The next page (A53) starts with a sentence stating: "A subsequent examination was made on February 25, 1971." This and the sentence which follows have already been discussed. Although Bruder expressed no difficulty recalling his visits of January 12, 13, 15 and 25, 1971, he repeatedly balked when a suggestion was made that he had visited Sloan's office on February 25, 1971. He initially testified that he could not recall the date of this visit. (A76). The only time he used the date of February 25, 1971 (A86) occurred at a point at which he could easily have been confused between that date and the date of January 25, 1971 (see e.g. A79). Taylor attempted to cross examine Bruder about what he found on February 25, 1971 (A120-121) but Bruder could not recall that as being the date of a visit to Sloan's office. (A121). This touched off a lengthy colloquy when Rashes succeeded in obfuscating the issue by an objection. (A121, line 18). His objection was : "I don't understand the question." There is, of course, no legal basis for an objection on the grounds that one of the attorneys does not understand a question being propounded to a witness. The question was, incidently, "Was that your prior testimony?" (A121, line 17). During the two pages of colloquy which followed his obviously frivolous objection, Rashes said that he had no recollection of Bruder's prior testimony concerning the February 25, 1971 date and asked "could we go back and check the testimony." (A123, lines 15-17). Finally, when the witness was permitted to answer the question which had been propounded two pages earlier (A121), he said (A123-124):

> "A. We seem, in my opinion now, we seem to be a little confused with certain other schedules submitted prior to this one. Now, I think accordingly, either I am confused on it at this particular moment or you are."

In the end, it proved impossible to cross examine Bruder concerning what he testified to about his visit of February 25, 1971 because he could not re-

call that he made a visit on that date. Clearly, under these circumstances, the fact findings made by the S.E.C. concerning the supposed February 25, 1971 visit are not supported by substantial evidence.

The third line of the first paragraph of the third page of the S.E.C.'s decision (A53) quickly skips, without so stating, from the testimony of Bruder to the testimony of Kanoff. That sentence states:

> "A March 19 examination revealed a capital contribution on the books of $58,175 when, in fact, no such contribution had been made."

From the sound of it, this would seem to be a serious charge. Fortunately, however, like the other charges advanced by the S.E.C., this one has no basis. Kanoff's brief testimony on this point in his direct examination was so incoherent that Rashes, the S.E.C. attorney, was compelled to ask (A135): "Would you explain what you just said?"

However, Kanoff's further testimony was not enlightening. He testified as to what "I believe Mr. Sloan said" and stated that he treated the amount of $58,175 "as an item payable to Mr. Iny, and charged as a liability."

The sum of $58,175 comes into this case twice because in footnote 11 of the S.E.C.'s decision there is a finding that Sloan had a net capital deficiency of $15,961 on February 26, 1971. Kanoff testified that he arrived at this figure after deducting $58,175 from Sloan's capital. (A134-135). Thus, if the $58,175 were not deducted, and the record here demonstrates that it should not have been, then it would seem that Sloan was in compliance with the net capital rule on February 26, 1971.

Taylor attempted to demonstrate this latter point in his cross examination of Kanoff and to force Kanoff to admit that his computation was wrong. The cross examination on this point commenced on R203 and continued for eleven pages. (R203-205, A206-A212, R191). This cross examination, which like the direct examination, produced rather confused testimony, revolved around the fact that Kanoff had charged 2,000 shares of Kaiser Steel Corp., which Kanoff

valued at $64,000, to the firm of Sloan & Co. and had deducted a haircut of 30%, i.e. $19,200, from Sloan's net capital position while also deducting $58,175 as a loan payable to Iny. It is evident from the testimony of both Iny and Sloan (R396) that the 2,000 shares of Kaiser Steel Corp. did not belong to Sloan & Co. but instead belonged to Iny. Moreover, as Taylor observed, (A210-211):

> "I will state further than that, your Honor, and I would ask you to look at Exhibit 6E, and you will find that in the trial balance submitted by Sloan, he did not include the Kaiser Steel in his position.
> Mr. Kanoff did that based upon a limited Understanding at that time.
> JUDGE TRACY: I didn't understand that.
> MR. TAYLOR: I will show it to you."

It is clear from the record of this case including various documents submitted by Mr. Iny (R683-686) that Kanoff, of his own accord and for reasons never explained, treated 2,000 shares of Kaiser Steel Corp. which in fact belonged to Iny as capital of Sloan & Co. and then deducted $58,175, the price Iny had paid to purchase these shares, as a loan payable to Iny. Thus, the fact found in the S.E.C.'s decision is clearly erroneous and is not supported by substantial evidence. Sloan never said that the 2,000 shares of Kaiser Steel Corp. belonged to him and indeed it was against his interests to do so because without the 2,000 shares of Kaiser Steel Corp. Sloan was in compliance with the S.E.C.'s net capital rule. This particular fact can be determined by a simple computation which Sloan offered and Judge Ward received in evidence in the trial of <u>S.E.C.</u> v <u>Sloan & Co.</u> 71 Civil 2695 and which has been filed with this court as part of the record of the appeal from Judge Wards decision.

In any event, it is preposterous to claim that Sloan ever owed Iny the sum of $58,175 or any amount even close to that figure in view of Iny's testimony. Throughout his testimony, Iny repeatedly stated that he had not entrusted Sloan with a large sum of money because, although he "wouldn't question [Sloan's] honesty" (A365), he was "worried that there would be too much money in his hands" (A364) in view of the small amount of capital Sloan had (A352 A364) and accordingly Iny maintained possession of any securities that were

available. (A364). It can be seen from Kanoff's trial balance as of February 26, 1971 (R487) that Sloan had the sum of $2,705.86 cash in the bank on that date. It is sufficiently obvious that Sloan did not owe $58,175 to Iny on February 26, 1971 and Kanoff's statement to the contrary is nothing more than pure conjecture or speculation unsupported by any evidence, substantial or otherwise.

By now it should be apparent that the S.E.C.'s case is based primarily upon fantasy but nevertheless this laborious analysis must continue. The first sentence of the next paragraph states: "On April 8 our investigator was once more in respondent's office." (A53). For a change, there is testimony in the record to support this finding. (A136). However, the S.E.C. decision then goes on to assert that Sloan told Kanoff that he "had no books, per se" but instead had machine run debit and credit slips, implying that this constituted a violation of the S.E.C. bookkeeping rules. To be sure, Kanoff did testify this way (A136) in his brief direct testimony concerning the April 8, 1971 visit. (A136-137).

Three pages of the cross examination (A220-222) were devoted to asking further questions about these machine run debit and credit slips. The questioning on this point concluded as follows (A221-222):

"Q. Could you describe what those records were, please?
A. Well there were two kinds, as I recall.
A separate ticket allowing for -- a journal-type ticket allowing for a debit and credit of the same item between two accounts, and a larger sheet, where his entries would be marked on.
Q. In your experience and from your familiarity with the type of record keeping, were they the usual kind of record you would see in a computer system, if you know?
A. Yes."

Near the end of the administrative hearing, Sloan testified about a meeting at the offices of the S.E.C. in April, 1971 (R440) which meeting was called because Sloan and Kanoff were in disagreement as to whether the computer record keeping service Sloan had engaged to do his bookkeeping, produced records which complied with S.E.C. rules (R440, A381, R442). Sloan testified that he produced all of his journals (which Kanoff called "memo slips") for the month

of March, 1971 (R440) and that these documents were examined by Joseph Barton, who was then head of the broker dealer inspection division of the S.E.C. in Kanoff's presence. Sloan testified that Barton told Kanoff that "these records provide an adequate means whereby Mr. Kanoff could conduct a meaningful broker-dealer inspection of [Sloan's] books and records." (A381).

Kanoff was called as a rebuttal witness and was asked questions concerning his version of the same meeting. (A392-296). Kanoff testified that Barton had said that the records "were not sufficient to qualify under the requirements of Rule 17A5" but that he could not remember the reasons Barton had given. (A393). However, when pressed, Kanoff said that there was no recording of the certificate numbers on the delivery bills. (A393-394). On cross, Kanoff testified that he could not recall all the records that were produced by Mr. Sloan (A395) but that he had brought certain of the memo tickets and certain machine runs with him. (A395). Unfortunately, Barton, who was Kanoff's superior at the time of the April, 1971 meeting, had retired from the S.E.C. shortly thereafter and the S.E.C. did not produce him as a witness at the administrative hearing and consequently this difference in the recollections of Sloan and Kanoff went unresolved.

All of this went unnoticed in the decision of the S.E.C. It is possible that the Commissioners, in reading the transcript, if they read the transcript, did not realize that this testimony concerned the same "machine run" "debit and credit slips" which were the subject of one sentence of the S.E.C.'s decision. However, it is clear that Kanoff did not testify that Sloan's record keeping service, which was incidently employed by numerous other Wall Street brokerage firms, inherently violated any S.E.C. rule. In short, the rule violation implied by the second, third, and fourth sentences of the second paragraph of page 3 of the S.E.C.'s decision (A53) is not supported by substantial evidence.

The next sentence states:

"Having received the March 31 trial balance eleven days after his April 8 request for it, he returned to registrant's office on May 6 to verify it. But he could not do so. He was unable to obtain the stock record and daily blotter."

To begin with, as noted previously, S.E.C. Rule 17a-3(a)(11), which is quoted in footnote 9 of the S.E.C.'s decision, (A53), only requires that a trial balance be prepared at least once a month. Kanoff testified that he received a Sloan trial balance on March 19, 1971. (A132). Thus, even if it were true that Sloan made Kanoff wait until April 19, 1971 for the next trial balance, this fact does not demonstrate that Sloan violated any rule of the S.E.C. Also, it should be pointed out that S.E.C. Rules 17a-3 and 17a-4 merely require Sloan to make and preserve monthly trial balances. No rule of the S.E.C. in effect at the time of the events in question required Sloan to deliver copies of his monthly trial balances to the offices of the S.E.C.

Regarding the May 6, 1971 visit, it appears that Taylor, who was generally careful to cross examine Kanoff and Bruder concerning every date, forgot to cross examine with regard to this date.

Thus the question of the sufficiency of the evidence concerning the May 6, 1971 visit must depend on what Kanoff said on direct examination. Kanoff's testimony concerning the May 6, 1971 visit can be found on A138. The pertinent testimony, in its entirety, was as follows:

"Q. Were you able to verify this March end trial balance?
A. No, I was not.
Q. Why were you not able to verify it?
A. I was unable to locate or Mr. Sloan to furnish me with certain delivery bills, certain confirms, stock record and daily blotter."

To begin with, the Commissioners, in their decision, used the word "obtain;" a word not employed by Kanoff. The statement that Kanoff "was unable to locate" the stock record or that Sloan did not "furnish" the stock record has a different connotation than the statement that Kanoff could not "obtain" the stock record. Although the difference might seem minor, it is signifi-

cant to note that the S.E.C.'s proposed findings of fact (R1032 ¶20) used the word "obtain." This might lead one to conclude that the Commissioners read the proposed findings of fact rather than the transcript. In any event, the real question, in view of Taylor's failure to cross-examine, is whether Kanoff's conclusory statement, standing alone, provides sufficient evidence for a fact finding. It is submitted that the answer is clearly no. Kanoff failed to provide any details or background information which "a reasonable mind might accept as adequate to support" the conclusion that he was unable to obtain the stock record or the daily blotter. Although Kanoff testified that he "visited Sloan & Co." on May 6, 1971 (A138) he did not state whether Sloan was there or whether the office was opened or closed or what time of day he made this visit or to whom he spoke or what he said or what efforts if any he made to obtain the stock record and the daily blotter. It should be noted that in most instances questions such as this are answered in Taylor's cross examination. Indeed, it has been seen that more often than not , the fact findings of the S.E.C. seem to derive their basis from testimony developed in cross examination rather than on direct examination. It seems that the strategy of the S.E.C. attorney was to develop a record which provided as little information as possible while still making some kind of case against Sloan.

It is possible that Taylor did not overlook the May 6 date but rather did not ask about that date because Kanoff could not recall it on cross examination. The testimony which leads to this conclusion was as follows: (A222-224):

"Q. Now, Mr. Kanoff, did you then request an April 30th trial balance from Mr. Sloan?
A. Yes.
Q. What date was that that you requested it?
A. I don't recall the date that I made that request.
....
Q. Is it your testimony that the April 30th trial balance was never forthcoming from Mr. Sloan?
A. That's correct."

Q. Did you then go to his office to take over an April 30th statement?
A. No, I did not.
Q. Is there any reason why you did not?
A. I believe I was directed not to bother to press him for the April figures.
Q. Tell us who directed you that way.
A. I believe it was Mr. Nortman."

This testimony tends to show that Kanoff did not visit Sloan's office on any date in May, 1971 and therefore appears to conflict with Kanoff's prior testimony concerning his May 6, 1971 visit. However, this point need not be explored further in view of the lack of substantial evidence to support the S.E.C.'s findings concerning the May 6, 1971 visit.

It should also be pointed out that when Kanoff later testified at the trial before Judge Ward, he changed his prior testimony. This time, he stated on direct (Transcript, p. 52):

> "Certain records were not forthcoming from Mr. Sloan that I needed to verify. Delivery bills. Basically delivery bills."

Thus Kanoff did not repeat his prior testimony about his supposed inability to obtain the stock record and the daily blotter. It should also be mentioned that it is preposterous to suppose that Sloan could operate a going stock brokerage business without a stock record and a daily blotter. In addition, even Kanoff's testimony that he could not obtain delivery bills was not substantial evidence since on cross he testified that he could not recall which ones. (Transcript p. 167-168).

The next sentence of the S.E.C.'s decision skips three months from May 6, 1971 until August 10, 1971. The decision makes it appear as though nothing of note happened during those three months. In reality, it was during this period that the S.E.C. commenced its lawsuit against Sloan, obtained a ten day temporary restraining order, stopped all of Sloan's checks and froze his bank account. Apparently, it would seem from the preceeding analysis, all of this was done for no reason. It is notable that the decision does not find

that Sloan was in violation of the S.E.C. bookkeeping rules and net capital rules on June 17, 1971, the date the lawsuit was commenced, or on any immediately preceding date. The most recent date of any alleged violation of the net capital rule was February 26, 1971 (see A53 n.11) and that was based upon Kanoff's clearly erroneous deduction of $58,175 as a loan payable to Iny. The most recent alleged violation of the bookkeeping rules was on May 6, 1971 and that allegation has a flimsy basis as was just demonstrated.

The decision of the S.E.C. next states:

> "On August 10 he went to the registrant's office to make an inspection. But the books were unavailable. 7_/ When he was able to make an inspection two days later, he found the general ledger posted only through July 31."

Then, in footnote 7, the decision states:

> "Our inspector testified he was told respondent's accountant had them."

The first thing that should be said about this sentence concerns the reference to respondent's accountant, Mr. Taylor. Taylor had been, in effect, appointed Sloan's accountant by the S.E.C. This came about as a result of the lawsuit commenced by the S.E.C. on June 17, 1971. On June 21, 1971, the S.E.C. obtained a temporary restraining order after a meeting in Judge McLean's chambers. Sloan and his attorney, Mr. Weiss, then proceeded to the offices of the S.E.C. where they met with Mr. Nortman and Mr. Barton. At this time a tentative agreement was reached whereby the S.E.C. would request that the temporary restraining order be lifted on the prior condition that Sloan agree to have a certified audit prepared by an accountant satisfactory to the S.E.C. Sloan's present accountant, a Mr. Leon, was apparently not acceptable. (A332). When Sloan agreed to this, Barton contacted Taylor, who apparently was and still is a personal friend of Barton (see R201, R442), and introduced Taylor to Sloan over the telephone. Sloan and his counsel then proceeded to Taylor's office where Sloan agreed to pay Taylor the sum of $1,200 to prepare and file with the S.E.C. a certified X-17A-5 financial statement. On June 23, 1971,

Sloan, Weiss and Nortman, the attorney for the S.E.C., appeared in Judge McLean's court and, after a lengthy colloquy, Nortman agreed that the temporary restraining order would be lifted only after Sloan's counsel, Weiss, gave his express representation that Sloan would hire Taylor as his accountant. (Transcript of June 23, 1971, p. 18, lines 18-20 which can be found in the appendix of S.E.C. v Sloan & Co. Docket No. 74-1436 .)

Approximately one year later, Sloan was sufficiently satisfied with the efforts of his S.E.C. appointed accountant that he decided to hire him as his attorney to defend himself in this proceeding brought by the S.E.C.

The statement in footnote 7 of the S.E.C.'s decision implies that if Sloan's books were in the possession of Sloan's accountant, Sloan would be in violation of the S.E.C.'s bookkeeping rules. However, the fact is that at a meeting on July 28, 1971 at the offices of the S.E.C. with Weiss, Taylor, Nortman and Kanoff present (A375), an agreement was reached whereby, among other things, Taylor, Sloan's accountant, would submit information regarding Sloan's financial position to the S.E.C. (A375-377). Taylor unsuccessfully attempted to bring this out in his cross examination of Kanoff. (A234). However, Kanoff did testify that he recieved Sloan's July 31, 1971 trial balance and other documents from Taylor. (A149-150). Indeed, these documents are part of the record of this case (R520-589), although the cover letter, which presumably would bear a date stamp showing when it was received by the S.E.C. was left out. (A150). In short, it is obvious that Taylor would need to have access to Sloan's books in order to prepare the voluminous materials which he submitted to the S.E.C. Thus, what the S.E.C. finds in footnote 7 of its decision to be a violation of the S.E.C.'s recordkeeping rules can be seen to be part of Sloan's almost limitless efforts to cooperate with the S.E.C. and to provide the S.E.C. with whatever information was requested.

However, returning to Kanoff's testimony concerning his August 10, 1971

visit , the fact is that Kanoff has since recanted his testimony and has offered a different version of the facts. In his testimony at the administrative hearing, Kanoff testified extensively concerning a conversation between himself and Sloan on August 10, 1971. (A154, A234-237). Kanoff also testified that on this occasion he overheard telephone conversations between Sloan and unknown third parties (A238) and observed other evidence which indicated that Sloan was actively engaged in doing business. (A238-242). However, Sloan testified that he was at home in bed on the occasion when Kanoff arrived in his office. (A373).

In November, 1973, Sloan filed a Special Supplemental Affidavit in the lawsuit which was then pending and asked Judge Ward to dismiss that action on the grounds that at the administrative hearing perjury well known to the S.E.C.'s legal staff had been committed in respect to (1) a deposit slip reflecting a deposit of the sum of $10,000 (A128), (2) the claim that Sloan had not given the S.E.C. an April 30, 1971 trial balance (compare A137, A222-224 to A368-369), and (3) the August 10, 1971 visit. Concerning the August 10, 1971 visit, Sloan made a charge, repeated in a letter included in the record here (top of A427) that Rashes accompanied Kanoff on his visit to Sloan's office on August 10, 1971 and therefore well knew that Sloan was not present on that date and that consequently Kanoff could not have had the conversations with Sloan which he testified that he had nor could he have observed Sloan conducting business over the telephone. When the case came to trial before Judge Ward, Kanoff testified concerning his August 10, 1971 visit only after consulting a memorandum, which he did not consult at the administrative hearing, and testified on cross as follows. (Transcript p. 183, line 5):

Q. It was August 10th?
A. Yes.
Q. When you walked into the offices of Sloan and company, was Mr. Sloan present?
A. No. I don't believe you were.

Concerning his August 12, 1971 visit, Kanoff repeatedly refused to testi-

fy that he observed any evidence that Sloan was doing business on that date although under obvious pressure to do so. At one point Kanoff testified on direct. (Transcript p. 67, line 11):

> "Q. Mr. Kanoff, did you observe Sloan & Co. doing business on August 12th?
> A. I really don't recall, Mr. Selvers."

After thusly being rebuffed, the S.E.C. attorney tried again. (Transcript p. 67, line 20):

> "Q. Did you examine the long and short position of that date?"

After consulting a memorandum (Plaintiff's exhibit 8) and after a brief discussion, Kanoff replied. (Transcript p. 68, line 11):

> "A. I have no recollection of doing that and this memo I have just looked at doesn't indicate that I did."

It is thus clear that Kanoff's testimony in the trial before Judge Ward is in direct conflict with his testimony at the administrative hearing and that this conflict cannot be resolved without a concession from the S.E.C. that Kanoff's testimony was false in either one place or the other. This conflict, as noted previously, was the subject of a motion for leave to adduce additional evidence addressed to this Court and denied on April 6, 1976. The S.E.C.'s opposition to this motion claimed, in essence, that even though Kanoff testified at the administrative hearing that he had a conversation with Sloan in his office on August 10, 1971 whereas at the trial before Judge Ward he testified that Sloan was not in this office on that date this would not effect Kanoff's testimony that he observed confirmation on that date. In other words, the S.E.C. argued that even though Kanoff's testimony was false on one point concerning what he observed on Agusut 10, 1971, it must be deemed to be true on something else. There are several obvious replies to this argument. However, without getting too deeply into this point it should be observed that Kanoff testified on direct that he could not recall what months the confirmations were for (A154) and, on cross, repeatedly stated that again he could

not recall the dates. (A236-237).

At oral argument on the motion in this court for leave to adduce additional evidence, counsel for the S.E.C., Mr. Wade, stated that Kanoff's testimony at the administrative hearing was that he spoke to some person, not necessarily Sloan, in Sloan's office on August 10, 1971 and that consequently Sloan's motion should be denied. This statement is characteristic of the irresponsible attitude displayed by the various S.E.C. attorneys throughout this case particularly since, after oral argument was completed and the motion was denied, Mr. Wade confessed to Sloan in private that he had not read the transcript. In his testimony concerning the confirmations he claims he observed on August 10, 1971, Kanoff testified. (A237):

> "A. In speaking to Mr. Sloan, seated at his desk, they were on his desk."

It is obvious from this that if Sloan was not in his office on August 10, 1971, Kanoff could not have observed the confirmations under the circumstances he described nor could he have observed Sloan giving securities quotations over the telephone nor could Sloan have told Kanoff that his accountant had the books. Thus all of the findings of the S.E.C. with regard to the August 10, 1971 visit are not supported by substantial evidence.

The same point applies as well to the S.E.C.'s findings concerning the August 12, 1971 visit. At the administrative hearing, Kanoff testified concerning what he observed which led him to believe that Sloan was doing business. At A156 he stated flatly that Sloan was doing business on August 12, 1971. At A194 he testified that he "detected" that Sloan was doing business in July, August and September, 1971 by the fact that during his two August visits he observed "confirmations about," "runners coming in" and telephone confirmations." It should be noted that Kanoff testified that he never visited Sloan's office from June 9, 1971 until August 10, 1971 (A156-157) and, at the trial before Judge Ward, Kanoff testified that he did not visit Sloan's office

from August 12, 1971 until August 16, 1973. (Transcript p. 180). Thus, it was preposterous for Kanoff to testify that he observed that Sloan was doing business in July, August and September, 1971 on the occasion of his two visits which took place only in August, 1971 and not in either July or September, 1971.

As noted previously, at the trial before Judge Ward, Kanoff testified that he did not observe Sloan doing business on August 12, 1971. (Transcript pp. 67-68). Since this testimony directly conflicts with his testimony at the administrative hearing, it negates any probative value Kanoff's testimony might otherwise have about what he observed at the time of the August 12, 1971 visit. In addition, if Sloan did no business between July 31, 1971 and August 12, 1971, there would be no reason for him to post the general ledger during any of the intervening dates.

The last paragraph in the section of the S.E.C.'s decision dealing with recordkeeping violations (A53) says that the "foregoing chronicle shows extensive and persistant recordkeeping deficiencies during the first eight months of 1971." However, as has just been demonstrated,the record establishes nothing of the kind and, to the contrary, it is evident that Sloan kept extensive records. Bruder testified that on the occasion of one of his visits he spent six hours examining Sloan's records (R87) and clearly Bruder would not spend six hours examining Sloan's records if Sloan had no records. Apparently, Kanoff never undertook a detailed examination of Sloan's records except when he first visited Sloan's office on March 19, 1971. At the trial before Judge Ward, Kanoff testified as follows. (Transcript p. 180, lines 2-12):

Q. Between May 31st of 71 and August 16, 1973, you never went to the office of Sloan to examine his records?
A. As I recall, my visits from this point only were to pick up material rather than examine the records.
Q. As a matter of fact, Mr. Kanoff, the only time that you examined the records of Sloan and Company was on March 19, 1971, is that correct?
A. At your offices?
Q. That's correct.

A. I really don't recall, but I would go along with that."

Since Kanoff testified that he did not actually examine the records, it follows that his testimony does not establish "extensive" violations by Sloan of the recordkeeping rules.

In footnote eight, the decision of the S.E.C. states:

> "Sloan's claim that he gave our staff certain papers (a deposit slip, a trial balance, and a stock record) has no bearing on these deficiencies."

The claims to which this refers were articulated by Sloan during the hearing and in a letter submitted by Sloan after the hearing. (A424-427). However, the decision of the S.E.C. ignores the fact that the focus of Sloan's letter was on the point that the S.E.C. attorneys had knowingly permitted their witnesses, Bruder and Kanoff, to give false testimony, upon which false testimony these attorneys relied in their briefs and other submissions. For example, at the administrative hearing, Bruder testified. (A128):

> Q. Did you ever see a deposit slip?
> ....
> A. I didn't see the deposit slip.

The existance or non-existance of this deposit slip has a direct bearing on the question of whether Bruder acted properly in deducting $10,000 in computing Sloan's net capital as of January 31, 1971. Sloan's letter (A426) states that Rashes well knew that Bruder had seen the deposit slip and indeed that Rashes had the deposit slip in his hand when he asked Bruder the question. Subsequently, the deposit slip was offered into evidence by the S.E.C. in the trial before Judge Ward. This was clearly a tactical manuver since the S.E.C. knew from Sloan's pre-trial motion to dismiss that Sloan intended to use the existance of this deposit slip as a basis to attack the credibility of the S.E.C.'s entire case. Thus, by offering this deposit slip into evidence and purporting to prove something with it, the S.E.C. had reason to know that it

would soften the blow it would sustain if Sloan succeeded in forcing the S.E.C. to produce this deposit slip. The S.E.C. employed the same tactical manuver after Sloan forced it to produce and admit the receipt of the April 30, 1971 trial balance.

At the administrative hearing, not only did the S.E.C. fail to produce the deposit slip after Bruder apparently made a mistake in his testimony, but the alleged non-existance of the deposit slip effectively became part of the S.E.C.'s case against Sloan. When the administrative law judge referred to a "$10,000 gift......which was not supported" he was evidently referring to the fact that, according to Bruder's now known to be false testimony, Sloan had failed to produce the deposit slip showing a deposit of $10,000 although requested to do so.

The second matter referred to was the April 30, 1971 trial balance. Kanoff testified unequivocally that Sloan had not provided the S.E.C. with an April 30, 1971 trial balance. (A137, A222-224). Sloan testified with equal assurance that he had submitted to the S.E.C. an April 30, 1971 trial balance (A368-369) and when asked the specific date on which he had done this Sloan stated, (A370):

> "I honestly don't recall. I am sure if the Commission will search their records, they will see that this document was received and they will find the date."

After the hearing, the S.E.C. submitted proposed findings of fact and one of the proposed findings of fact was that "a trial balance requested from Sloan & Co. for the end of April, 1971 was never submitted to the Commission." (R1032 ¶17). This alleged fact was emphasized in the S.E.C.'s supporting brief. (R1079). Subsequently, the administrative law judge, when faced with this and other conflicts between the testimony of Sloan and Kanoff, specifically found Sloan's testimony to be "not worthy of belief." (A43).

More than one year later, when the case came to trial before Judge Ward, Kanoff again testified that Sloan had not given the S.E.C. a copy of his April 30, 1971 trial balance. (Transcript p. 50, line 20, p. 170, line 23). However, after first being rebuffed, (Transcript p. 171, line 2), Sloan obtained an order requiring the S.E.C. attorneys to search their files for the trial balance. (Transcript p. 285, line 20). The S.E.C. complied, produced the trial balance which it previously had claimed it had never received, and was forced to withdraw two of its proposed findings of fact relating to the alleged non-existance of the trial balance. (Transcript p. 353, line 12). Later in the trial, the S.E.C. explained that the trial balance had been found in the files of one of the attorneys to whom this case had been assigned. (Transcript p. 558).

However, that did not end the matter and indeed the way the S.E.C. attorneys conducted themselves subsequent to admitting the receipt of the trial balance removes any doubt that the failure to disclose the existance of the trial balance at an earlier date was deliberate. Although the S.E.C. withdrew its proposed findings of fact with respect to the April 30, 1971 trial balance in the action before Judge Ward, it did not withdraw the identical finding of fact in its administrative proceeding which was still pending before the S.E.C. and the Commissioners themselves could not be expected to know what had occurred before Judge Ward. This led Sloan to write to the S.E.C. attorney in charge of prosecuting this administrative proceeding and to demand that the Commission be informed of these developments. (A433-434). The S.E.C. attorney who replied to Sloan's letter refused to do so, stating that the matters to which Sloan referred "are in no way material, in that they would not change the outcome of the administrative proceeding." (A432). When Sloan finally wrote to the S.E.C. directly, the same S.E.C. attorney responded by saying that the April, 1971 trial balance was offered into evidence by the S.E.C., which of course, was true, but only after Judge Ward's

order forced the S.E.C. to admit the existance of that trial balance. He also stated the trial balance "was not sufficiently accurate to allow a capital computation to be made." (A442).

This statement, combined with the S.E.C.'s presentation of its entire case here which has already been analyzed at some depth, clearly demonstrates a pattern of conduct by the S.E.C. attorneys assigned to prosecute Sloan. This pattern is to lie, to misrepresent the truth, to prevaricate and to make outrageously false claims and, as soon as Sloan refutes one claim, quickly to substitute another equally false claim in its place. Here, the S.E.C. claimed for two and one half years that Sloan never submitted an April 30, 1971 trial balance to the S.E.C. Finally after a tremendous struggle, Sloan obtained a court order which forced a concession that the trial balance was submitted in May, 1971 and that the S.E.C. attorneys had it in their possession all along, and these attorneys immediately rebounded with a claim that this trial balance "was not sufficiently accurate" which required a new response from Sloan.

It has been held that government prosecutors owe to the defendant "an unqualified duty of scrupulous candor." <u>Shotwell</u> v <u>United States</u> 371 U.S. 341, 358 (1963). However, the S.E.C. attorneys here have never even suggested that the failure to disclose the receipt of the April, 1971 trial balance at an earlier date was inadvertent and could not well do so in view of the revelation that it was found in the files of one of the S.E.C. attorneys who had been assigned to handle the case. Now that the document has been produced and the utter falsity of the charges advanced by the S.E.C. attorneys has been revealed, they assert that the entire matter is irrelevant and the S.E.C. agrees. (A53 n.8). However, it should be obvious that the matter is highly relevant particularly because the S.E.C.'s entire case is based upon evidence which would clearly be inadmissible under the common law hearsay

rules and whatever value the S.E.C.'s case has is based at least in part upon the presumption of honesty and integrity among the S.E.C. attorneys prosecuting this case. Thus, once it has been shown that these attorneys are neither honest nor do they have any integrity, the S.E.C.'s entire case against Sloan collapses. United States v. Rosner, 516 F.2d 269, 272 (2d Cir. 1975).

Moving on, the next sentence in the S.E.C.'s decision states:

> "Moreover, computations of net capital during that year were not prepared as required."

This finding is clearly erroneous and is not supported by any testimony in the record. At the administrative hearing, Sloan testified as follows, (A331):

> ".....for every single month, in 1971, I have a capital computation, and they are available in my office and Mr. Kanoff or anybody can come down and look at my records for that period, and see the capital computations for all the months."

This testimony went uncontradicted by any testimony from the two S.E.C. staff investigators and it is apparent that the S.E.C. did not take up Sloan on his offer to produce all of the capital computations since no S.E.C. investigator visited Sloan's office until more than half a year after the administrative hearing.

There is no indication in the record of the administrative proceeding that either Bruder or Kanoff ever asked Sloan to provide the S.E.C. with even a single net capital computation. The record establishes that on one occasion Taylor, Sloan's accountant, submitted a net capital computation to the S.E.C. although apparently not requested to do so. The S.E.C. did not offer this document into evidence. (A150). When pressed for an explanation for this, Kanoff testified that "the computation, as submitted, is redone in the office, anyway." (A152). At the trial before Judge Ward, Kanoff elaborated on this point further and stated that Sloan's own capital computation would be "meaningless" because it would be recomputed in the office of the S.E.C. anyway. (Transcript p. 136).

Judge Ward made a similar finding that Sloan had not made any capital computations. However, this finding was not supported by any evidence elicited in the trial before him. To the contrary, Sloan offered many capital computations into evidence, some of which were prepared by him, others by his accountants, Leon and Taylor. As noted previously, Judge Ward merely copied the S.E.C.'s proposed findings of fact and obviously did not check the transcript to see if there was any evidence to support his numerous fact findings.

On appeal, the S.E.C. in its brief asserted that "a detailed account of each and every violation is unnecessary to sustain the judgment below," (Brief in 74-1436 , p. 9), an obvious concession to the fact that many if not all of the findings were not supported by the record. One of the many findings apparently abandoned by the S.E.C. was Judge Ward's finding #15 regrading capital computations. That finding should be abandoned here as well.

It should be noted that during the trial before Judge Ward, the S.E.C. attorneys repeatedly read from prior testimony supposedly given by Sloan at the administrative hearing and from other Sloan testimony regarding the matter of capital computations. The S.E.C. attorneys expressly represented to the court that Sloan was not telling the truth and that his prior testimony was in conflict. (Transcript p. 831, line 25). However, when testifying before Judge Ward, Sloan did not have the opportunity to see his own prior testimony, a practice followed by Judge Tracy here. (A304). This was and is a clear violation of the Federal Rules of Evidence. Subsequently, after the trial, when Sloan was finally given the opportunity to read the transcripts to which access by him had been denied by pre-trial discovery order of Judge Ward, Sloan was able to observe that he had not in fact given the testimony which the S.E.C. attorneys had purported to be reading into the record and that his testimony that he did not recall that it had happened that way (Transcript p. 829) which testimony the S.E.C. attorneys had used as a basis for asserting that Sloan was not telling the truth, was correct in that

it had not happened that way and that the S.E.C. attorney was misreading the transcript. This circumstance led Sloan to file a Fed. R. Civ. P. 60(b)(3) motion to vacate the judgment on the grounds of fraud, misconduct and other misrepresentation of an adverse party. In support of this motion, Sloan filed a thirty page brief which analyzed the testimony concerning capital computations in detail. That brief can be found in the record of S.E.C. v Sloan & Co. 74-1436 which is still in the files of this court.

Ultimately, the sole basis for the S.E.C.'s claim, if it is still making that claim, that there is evidence to support the finding that Sloan did not do any net capital computations for 1971, is derived from a transcript of Sloan's testimony on January 21, 1972. The transcript, which is not part of the record of this appeal due to Judge Tracy's failure to observe the Federal Rules of Evidence (A304), indicates the following testimony (page 23):

> "Q. The question is, have you prepared a capital computation for January 1, 1971 through December 31, 1971 in accordance with Section 17(a)(3) of the Securities and Exchange Act?
> A. No.
> Q. Mr. Sloan, I believe you have stated before, from your capital computation, you have determined that you are in compliance in December, will you furnish this office with the capital computation that you have made that leads you to believe that you were in compliance in December?
> A. Yes."

Later, on page 33 of the same transcript, Sloan was asked:

> "Q. In figuring your capital computation, Mr. Sloan, and I believe we have already requested that copy of whatever you used to figure that, how do you treat the note from J.S. Love.
> A. I don't count it as a good asset....."

Finally, on page 34, the last page of the transcript, Rashes stated:

> "Q. And as we have been doing right along, will you supply the office with the January, 1972 capital computation and trial balance which would be ready sometime in the middle of February?
> A. Yes."

Thus, if anything is established by the January 21, 1972 transcript, which the S.E.C. attorney was reading from out of context at A333, it is that Sloan did do the net capital computations. Significantly, Sloan was never given the opportunity to settle the January 21, 1972 transcript, a right which has constitutional deminsions, Chessman v Teets 354 U.S. 156 (1957), and had Sloan been given this opportunity, he would have been able to point out an obvious error in the transcript made by the court reporter with respect to Sloan's answer to a question which is leading and ambiguous. However, not only was Sloan prohibited from settling the transcript of his own prior testimony, but he was prevented from even reading it until after he testified in the trial before Judge Ward, more than one year after the administrative hearing, and only then was permitted to read it because the transcript was marked as an exhibit and offered into evidence by the S.E.C.

This discussion should serve to demonstrate the validity of the principle that the Federal Rules of Evidence should be adhered to even in administrative proceedings. The Federal Rules of Evidence are not arbitrary guidelines; rather they reflect a collective wisdom accumulated through untolled man - years of experience by numerous trial judges and lawyers. These fundamental rules should be observed at an administrative hearing just as they are in any court case.

The next sentence of the S.E.C.'s decision states:

> "And our staff generally had to make about two or three requests for each trial balance it obtained from registrant."

The sole basis for this finding is a statement by Kanoff on cross examination (A223), which was not responsive to the question asked. Clearly, Kanoff was generalizing and his testimony does not constitute "substantial evidence" particularly since he directly contradicted this testimony when he testified that Nortman directed him not to bother to press Sloan for the April,

1971 or the May, 1971 trial balance. (A224).

Moreover, at the trial before Judge Ward, Kanoff explained the policy of the S.E.C. with respect to requests for trial balances as follows. (Transcript p. 166):

"Q. May I ask you, what is the policy of the Securities and Exchange Commission on requesting trial balances from brokers? What date were they due?
A. They are due on various dates pursuant to various rules, Mr. Sloan. Ten to fifteen days I think would be the average.
Q. Is it the policy of the Securities and Exchange Commission to ask for trial balances no sooner than ten days after the end of the month?
A. We ask for it sooner but we assume we won't get it until the end of the month.

From this testimony, it is obvious that no violation of any S.E.C. rule can be imputed from the finding that Kanoff had to make about two or three requests for each trial balance he obtained from Sloan. In addition, as noted previously, the S.E.C., in its proposed findings of fact, made no claim that Kanoff had to make two or three requests for each trial balance. Rather, this claim seems to have been derived from the S.E.C.'s "independent review of the record" (see A51 n.2)which clearly deprived Sloan of his constitutional right to adequate notice.

Footnote 10, the last footnote dealing with findings of violations by Sloan of the S.E.C.'s recordkeeping rules,states:

> "Ultimately, however, it obtained almost all of the trial balances it requested."

As there is nothing in the record either way which supports this finding, it is not supported by substantial evidence.

That completes this laborious and lengthy analysis of the claims by the S.E.C. that Sloan violated the S.E.C.'s recordkeeping rules. If reading this analysis is an exhausting task, one must consider how much more exhausting it must have been to write it. This approach has been made necessary by the

general shotgun approach of the S.E.C. which is to hurl a variety of unfounded and frivolous charges at Sloan in the apparent hope that one of them will be on target. Unfortunately, Sloan's Herculean labors in responding to these charges have not ended yet because now it is necessary to deal with the alleged violations of the S.E.C.'s net capital rule.

C

THE FINDING OF THE SECURITIES AND EXCHANGE COMMISSION THAT THE PETITIONER WILFULLY VIOLATED THE NET CAPITAL RULE IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE.

In footnote eleven of its decision (A53), the S.E.C. sets forth claimed deficiencies in Sloan's net capital on eleven dates and states: "and respondent does not challenge these findings." This was hardly the case. Taylor's cross examination of Bruder and Kanoff demonstrated that these eleven net capital computations were riddled with errors and that therefore none of them had probative value. In addition, Taylor correctly characterized both Bruder's and Kanoff's overall testimony as "so absolutely incredible as to defy understanding." (R1118).

The capital computations offered into evidence by the S.E.C. are not competent under the common law rules of evidence. The common law rule that information derived from the books of a businessman is hearsay has ancient roots dating back to a time prior to the discovery of the New World. The S.E.C. seeks to cast aside this rule through its administrative process by offering documents into evidence which would not be admissible in court under either the best evidence rule or the rule relating to hearsay.

The computations submitted by Bruder and Kanoff bare little resemblance to the truth. Assets are recorded as liabilities and liabilities as assets. Numbers are copied incorrectly. Items which were in Sloan's general ledger are left out and items which were not in Sloan's general ledger are included in.

Many of the figures included in the computations made by Kanoff and Bruder are based purely upon conjecture and speculation or on presumed facts which were neither verified nor verifiable. Moreover, none of the security valuations are supported by evidence and many are clearly wrong. To cite one example, an item of 200 shares of Voplex Corp. is found in many of the S.E.C.'s lists of security valuations. Sloan valued the 200 Voplex Corp. at a price of $14 per share; the price at which it was selling on the American Stock Exchange. (R504, R579, R600). Kanoff, who was working from Sloan's figures, wrote the words "no quote" next to Voplex Corp. (R94, R608) and valued it at zero, thus reducing Sloan's capital by $2,800 in his computations for July 31, 1971 and August 31, 1971. It is obvious from his testimony that Kanoff simply made a mistake and overlooked the fact that Voplex Corp. is listed on the American Stock Exchange. (A230-232, A247-248).

This is not the only such mistake. The S.E.C.'s attitude towards this point is best demonstrated by the fact that it did not offer to correct the error after it was pointed out by Taylor and a year later when essentially the same case came to to trial before Judge Ward the same computations containing the same errors were offered into evidence by the S.E.C.

Moreover, in its brief submitted to the administrative law judge, the S.E.C. had the audacity to argue that, in effect, the burden of proof was on Sloan to demonstrate that Voplex Corp. was listed on the American Stock Exchange. (R1082). The fact is, of course, that no evidence was introduced by the S.E.C. to support its valuation for Voplex Corp. or for any of the other securities priced by the S.E.C. and in an administrative proceeding such as this one, the burden of proof is on the S.E.C. See 5 U.S.C. §556(d). It should be pointed out that each net capital computation prepared by the S.E.C. was based upon the S.E.C.'s evaluation of a large number of securities. For example, on July 31, 1971, Sloan had 50 long positions and 21 short positions.

For each of Sloan's 71 security positions, the S.E.C. made a valuation (R591, 593, 594) and in the case of that month valued Sloan's total long position at $29,667.19 and his total short position at $139,083.50 (R590). From that point forward, the details of Kanoff's computations are virtually illegible. (R590). However, it is obvious that a relatively small percentage change in the security valuations would mean the difference in whether Sloan was regarded as being above or below the net capital requirement. This is particularly true in Sloan's case because all of the computations prepared by the S.E.C. indicated that Sloan had much more than the $5,000 minimum required capital. For example, the court ordered certified financial statement showed Sloan's capital to be $48,770.32. (R511).

In order to go from a net capital surplus to a net capital deficiency for many of the dates in question, Bruder and Kanoff performed feats of mental gymnastics in defiance of the rules of logic, not to mention the rules of evidence. With regard to the January 29, 1971 computation, it initially should be pointed out that Sloan filed with the S.E.C. a certified X-17A-5 financial statement prepared by Raymond Leon, a certified public accountant, as of the date of January 29, 1971. This statement showed Sloan's net capital on January 29, 1971, after all deductions and haircuts, to be $9,529.99 or $4,529.99 in excess of the $5,000 minimum. This document is included in Sloan's Broker-Dealer file which is part of the record of this case as document no. 87 (A10) and can be found as plaintiff's exhibit one in S.E.C. v Sloan & Co. 74-1436.

Although this document would presumably be of aid to Bruder in preparing his own computation of Sloan's capital on the same date, he testified that he did not look at it. (A126-127). This fact should demonstrate the arrogant attitude of the S.E.C. investigators and in particular Mr. Bruder.

On direct examination, Bruder was asked to state merely the total amount of Sloan's net capital deficiency on January 18, 1971 (A74) and on January 29, 1971. (A83). No explanation was requested or offered as to how Bruder

arrived at his figures. However, on cross examination, when Taylor, who was, it should be remembered, a certified public accountant (R500), started to ask a few questions, it quickly became apparent that Bruder's computations were nonsense. (See A98-103).

In order to follow and to understand the significance of this cross examination, it is necessary to look at Bruder's actual computations (R476, R480) which are, again, nearly illegible and to compare them with the computations Sloan submitted (R475). It can be seen from similiarities in the two statements that both are derived from the same original source. For example, Sloan lists his cash in bank as $5,716.58 whereas Bruder lists Sloan's cash in bank as $5,716.98. Since Sloan's figures are in balance, it is obvious that Bruder made a simple copying error which changed the figures by the amount of 40 cents. There is also a difference in the fails to deliver, which Sloan designates as "Receivable from Brokers and Dealers," which is another way of stating the same thing. Sloan lists $26,032.68 and Bruder lists $25,043.46 as representing Sloan's current fail to delivers. However, by taking Bruder's figure of $982.22 representing "Acct. Receivable (COD)," which presumably means stock in the mail to brokers to whom Sloan was failing to deliver, and by adding to it Bruder's "fails to deliver" figure, one arrives at the sum of $26,025.68 which is only $7.00 away from Sloan's figure. Similarly, Bruders trading account long, $6,521.94, is almost exactly the same as Sloan's, $6,542.94; the difference being precisely $21. On the liabilities side, Bruder lists "Fail to Receive $7,317.01" and "Fail to Receive Inventory $2,192.50." This adds up to $9,509.51 which is not that much different from Sloan's "due to brokers and dealers," $9,565.76. Sloan's statement also has asset and liability items of $1,650.00 which are offsetting positions which do not affect Sloan's net capital. Thus, Sloan's computation, which was incidently prepared by Leon, his accountant, shows invested capital of $7,081.95 and undistributed profit of $5,719.70. However, working from essentially the

same figures of cash in bank, fails to receive, fails to deliver, and securities long and short, Bruder comes up with a net capital deficiency of $28,016 (last digits illegible) (R480). How he managed to do this was the subject of Taylor's cross examination of Bruder.

It appears that Bruder was incapable of comprehending the fact that it is possible for a broker dealer to operate at a consistent profit without having customers. Unable to find an account in the general ledger showing funds held for the account of customers (A101), Bruder went through Sloan's ledgers until he found what he said looked like a customers ledger. Taylor, who of course, later became Sloan's accountant and who knew that Sloan customarily did not have customers, said incredulously: "You insist that it was a customers ledger." (A101). What Bruder had stumbled upon was a listing dating back to the time when Sloan and Theodos were partners which said "receipts and payments, account of customers."(A100). Bruder then jumped to the conclusion that this listing of past receipts and disbursements actually represented monies currently due and owing to unnamed (see A100) customers. He then included three new items which he listed as non-current assets which are nearly illegible but, so far as they can be made out, state:

"Receipts Disbursements Related to Custs.	$ 460.63
Receipts Deliveries to Customers	9,851.25
Operating Expenses	5,135.05"

The sum of these three items is $14,446.93 and consequently Bruder's calculation of Sloan's assets and liabilities was thrown out of balance by this amount. In order to make up in part for this, Bruder put in an item on the liability side amounting to $10,043.90 which he labeled "unaccounted for difference" which was actually a plug figure to balance out the accounts which he had unbalanced by his other entries. (A98). He also included another item in the liabilities which he labeled "Receipts, Payments A/C Customers $11,010.13" after which Sloan's statement as prepared by Bruder was back in balance.

After this, Bruder took the total of "Unaccounted for Difference $10,043.90," Receipts, Payments A/C Customers $11,010.13" and "Fail to Receive $7,317.01" to arrive at the sum of $28,371.04 which he labels as "A.I." which means, obviously, "aggregate indebtedness." Apparently Bruder was on his way to calculating whether Sloan's "aggregate indebtedness" exceeded 2,000 per centum of Sloan's "net capital." See S.E.C. Rule 15c3-1(a), 17 CFR 240.15c3-1(a). At this point it should be obvious that Bruder was a man with an intellectual deficiency and, worse yet, was arrogant and failed to realize his own shortcomings. However, the reality that such individuals exist is a fact of life. What is remarkable here is that the S.E.C. attorneys would offer this piece of paper, which Bruder calls a net capital computation, into evidence and to claim that it has probative value in making a case against Sloan.

It should be noted that in Sloan's statement, "operating expense," an asset, was naturally merged into "income," a liability, and therefore was excluded. Thus, if the other figures were valid, which, of course, they are not, Bruder's "Unaccounted for Difference" would actually represent profits realized by Sloan. However, it is ridiculous to talk seriously about what an item would represent if Bruder had done his calculations correctly since it is obvious that this did not occur. Nevertheless, using Bruder's own figures and excluding only "Receipts, Disbursements A/C Customers" and the other items which are obviously neither assets nor liabilities, Sloan can be shown to be in compliance with the S.E.C.'s net capital rule on January 18, 1971. The calculation is as follows:

ASSETS

Cash in Bank		$ 5,716.98
Discounts Receivable (COD)		982.22
Fails to Deliver		25,043.46
Trading Account Long		6,521.94
	TOTAL	$38,264.60

LIABILITIES

Fail to Receive		$ 7,317.01
Fail to Receive Inventory		2,192.50
Firm Trading Short		15,924.79
	TOTAL	$ 25,434.30
Difference = CAPITAL		$ 12,830 30

From this it is necessary to deduct 30% of the longs plus shorts. See present Rule 15c3-1(c)(2)(iii)(d), 17 CFR 240.15c3-1(c)(2)(iii)(d). That calculation is as follows:

Trading Account Long		$ 6,521.94
Firm Trading Short		15,924.79
	TOTAL	22,446.73
Take 30%		.30
		6734.0190
Capital		12,830.30
Deduct 30% of longs plus shorts		6,734.01
Difference = Net Capital		$ 6,096.29

Thus, using Bruder's figures, Sloan's net capital can be seen to be $6,096.29 or $1,096.29 in excess of the S.E.C.'s net capital requirements.

The next date on which the S.E.C. claims that Sloan violated the net capital rule was January 29, 1971. With respect to this date, as noted previously, a certified public accountant filed a statement with the S.E.C. which was accepted by the S.E.C. which showed that Sloan had capital well in excess of the net capital requirements. Significantly, the S.E.C. has never challenged the validity or the accuracy of that financial statement but instead has ignored it in the S.E.C.'s litigation against Sloan. None of the many briefs and other documents filed by the S.E.C. has made any mention that this financial statement even exists.

As noted previously, Bruder, who did not bother to look at Leon's

certified financial statement, assuming that he had been informed by its co-workers of its existance,[5] made his own computation which showed a deficiency of $11,912 in contrast to Leon's statement which showed excess capital of $4,529.99. Thus, a difference of $16,441.99 exists between the two figures. A majority of it is accounted for By Bruders claimed $10,000 deduction as an "unconfirmed gift from Sloan's mother" and most of the rest comes from the difference in security valuations by Bruder and Leon. Significantly, Bruder did not repeat his idiodic deduction of $11,010.13 "Receipts, Payments A/C Customers" that he had made in his computation of Sloan's capital as of January 18, 1971, a date only 11 days earlier. However, he did something equally silly by deducting $10,000 for a supposed gift.

There is nothing in the record of the administrative proceeding or on Sloan's books[6] that shows that Sloan's mother ever gave or loaned Sloan the sum of $10,000. Where Bruder ever got this idea is mystery. Perhaps Bruder observed that Sloan's initial capital was $10,000 and concluded that Sloan was too young a man to have made this sum of money on his own and therefore must have gotten it from his father or mother. When Bruder learned that Sloan had a mother, he perhaps jumped to the conclusion that she must have been the source of Sloan's capital.

This suggestion is pure speculation but the record offers nothing better. Taylor spent four pages cross examining Bruder about this $10,000 item. (R68, A107-109). Bruder's testimony was incoherent. First he stated that he had written a letter to Sloan's mother. (R68, A107). This letter, however, was not produced or offered into evidence by the S.E.C. Then he said that

5. Kanoff testified that he analyzed the January 29, 1971 filing (A272). However, he did not and was not called upon to state the results of his analysis. It is obvious that Kanoff must have found that Sloan was in capital compliance on that date because otherwise the S.E.C. would have made the results of Kanoff's analysis part of its case against Sloan. Since Leon's statement was filed close to the time that Bruder retired from the S.E.C. (see A87), it is likely that Bruder never saw it.

6. Sloan's actual books are also part of the record in S.E.C. v Sloan & Co. 74-1436.

Sloan had told him that he had received a gift of $10,000 from Sloan's mother and that he had found it in the capital account of Mr. Sloan. (A107). However, he then changed his testimony and said, "It is not recorded in the assets. I have it in the liabilities, sir." (A108). The he said, "I stand corrected" and testified that his answer to a prior question was in error. (A108). Bruders best explanation was as follows (A108):

> "A. Well, it would be included in the over-all assets, maybe as cash in the bank or funds on deposit with another broker or it may be part of his fail to delivers."

What this testimony seems to add up to, if it can be said to add up to anything, is that there was no specific entry anywhere on Sloan's books indicating that Sloan received $10,000 or any other sum of money from his mother and that Bruder had deducted the sum of $10,000 from Sloan's capital because Sloan told him that he received $10,000 from his mother. This explanation does not make sense. It should be noted that the record contains two listings by Bruder of all of Sloan's general ledger accounts as of January 29, 1971 (R481, R484) and neither listing contains any item reflecting the receipt of a gift from Sloan's mother. Thus, if Sloan did indeed receive $10,000 from his mother, he did not include it in the assets of Sloan & Co. and there is no basis for deducting this amount from Sloan & Co.'s net capital.

Once it is recognized that Bruder had no valid justification for deducting the $10,000, it follows that his entire computation is wrong. It should be pointed out that Bruder not only deducted the $10,000 amount as an unconfirmed gift but he also included this sum in Sloan's aggregate indebtedness and 1/20th of that, or $500, was also deducted from Sloan's net capital. (R485). Thus, the total effect of this one item was to reduce Sloan's net capital by $10,500. This makes up almost all of Sloan's supposed net capital deficiency. The remaining deficiency is more than made up by the differences between Leon's and Bruder's valuation of Sloan's security positions. It is submitted that a certified report prepared by an independent certified public

accountant should be given at least as much weight as the almost illegible scribblings of Bruder, who, as was previously noted, may not, for all the record discloses, even have been a high school graduate.

The next date is February 26, 1971 where Kanoff computed a net capital deficiency of $15,961. This computation has been dealt with already. In sum, Kanoff deducted $58,175 as a loan payable to Iny and deducted from Sloan's net capital 30% of the market value of 2,000 shares of Kaiser Steel Corp. Both of these deductions were wrong since nothing in the record shows that Sloan owed Iny $58,175 or that Sloan owned 2,000 shares of Kaiser Steel Corp. Without these deductions, Kanoff would have arrived at a different figure altogether which would have shown Sloan to be over the S.E.C.'s net capital requirement. Sloan's exact computations demonstrating this point were offered and received into evidence in the trial before Judge Ward but these calculations need not be repeated here because it is obvious that Kanoff's computation was wrong and, as a result, the findings of the S.E.C. are not supported by substantial evidence.

The next finding skips four months until June 30, 1971. Here an entirely different situation is presented. During the intervening period, a dramatic change in Sloan's financial condition had occurred as a result of substantial trading profits realized by Sloan. However, on June 17, 1971 the S.E.C. took action to bring Sloan's activities to a halt by instituting a lawsuit against Sloan entitled S.E.C. v Sloan & Co. 71 Civil 2695 and by filing in court papers seeking an order temporarily restraining Sloan from buying and selling securities. The moving papers of the S.E.C. in support of its motion for a temporary restraining order expressed the belief which proved to be unfounded that Sloan was in the process of misappropriating large sums of monies belonging to unknown public customers. On the basis of this claim, which was utterly false since Sloan had no public customers and did no business with the public (R501), the S.E.C. obtained its temporary re-

straining order with the result that Sloan was prohibited from buying and selling securities and his bank account was frozen. This temporary restraining order was in effect from June 21, 1971 until June 24, 1971. However, the freeze on Sloan's bank account continued until June 28, 1971 because of the failure and refusal of the S.E.C. to notify Sloan's bank sooner that the temporary restraining order was no longer in effect. As a result, approximately eighty checks written by Sloan bounced on Wall Street.

The rise and fall of Sloan's financial fortunes is indicated by the changes in his bank account. On the date the freeze on Sloan's bank account went into effect, Sloan had $37,999.03 on deposit. (See trial transcript p. 559). This sum far exceeded Sloan's total capital in January or February, 1971. However, by June 30, 1971, Sloan's bank account had shrunk to $2,391.76. (R511). This change represents the devestating effects of the temporary restraining order.

The question here is whether, under these circumstances, it can be said that Sloan wilfully violated the net capital rule. It is true that by June 30, 1971 Sloan's capital position had deteriorated. This is not to say that Sloan was broke. To the contrary, his capital on June 30, 1971, even after the devestating results of the temporary restraining order, was still $48,770.32 (R511), a figure accepted by the S.E.C. (R519).

Here, a point should be made concerning an obvious fallacy in the way that net capital is computed. To take a hypothetical example, suppose that Sloan owned 2,000 shares of XYZ Corp. valued at $10 on June 23, 1971. Securities trades by custom settle on the fifth business day after the trade date. The settlement date for trades of June 23, 1971 would therefore be June 30, 1971. Continuing this not very hypothetical example, suppose that Sloan then sold his 2,000 shares of XYZ Corp. at $10 on June 24, 1971. This trade would then be scheduled to settle on July 1, 1971. However, on June 30, 1971, Sloan would be called upon to make his monthly trial balance and capital computation

and his balance sheet for that day would reflect his ownership of $20,000 worth of XYZ Corp. even though those shares had actually been sold by Sloan six days earlier. If, during the intervening six day period, the market price of XYZ had fallen from $10 to $5, Sloan's capital would be reduced by $10,000 and this change might have the effect of making it appear that Sloan was in violation of the net capital rule whereas in reality he was not because in this hypothetical example Sloan had already sold his stock and it could not be said that Sloan wilfully violated the rule if indeed he violated the rule at all. In short, any fluctuation in the value of the securities Sloan held in the intervening six days would have the effect of a bookkeeping entry and would not reflect reality because regardless of whether the stock was selling for $2 or $20 on June 30, 1971, the trial balance date, Sloan would still get $10 per share when he made his delivery on July 1, 1971 to fulfill his contract of June 24, 1971.

On cross examination at the administrative hearing, Taylor interrogated Bruder on a variation of this point. (A117-120). By his interrogation, Taylor sought to force Bruder to admit that the fact that changes appeared in Sloan's security positions between two different trial balance dates did not necessarily mean that Sloan bought or sold any securities in the intervening period. However, the significant fact here is that the method by which Sloan's capital was computed by Bruder, Kanoff, Taylor, Leon and, for that matter, Sloan himself does not reflect reality because inevitably at least some market fluctuation must occur between trade date and settlement date. To be sure, most of the time prices do not fluctuate radically between trade date and settlement date and therefore the S.E.C.'s method of computing net capital, however faulty, will produce a figure somewhere close to what the true net capital is, if indeed it can be said that there ever is a "true net capital."

The fundamental invalidity of the way net capital is computed was

recognized by Kanoff when he testified that he gave Sloan the "benefit of the doubt" because of the effect of the five day settlement (A196) even though that "benefit of the doubt" related to the question of whether Sloan was "doing business" and not to the question of whether Sloan had sufficient capital. However, the point is that it is entirely possible, particularly in the case of a broker such as Sloan who carries large security positions in a number of volital securities in relation to his capital, to show a net capital deficiency on a number of dates and yet never actually to have violated the net capital rule on any one date. In the case at the bar, this could occur because of a relatively small fluctuation in the price of even a single security between the trade date and the settlement date. For example, with respect to the June 30, 1971 date, Kanoff testified that Sloan had a net capital deficiency of $19,222. (A53). On this occasion, since a certified report was submitted as of that day, he accepted Taylor's security evaluations. (A146). Taylor evaluated Sloan's longs as $39,456.76 (R503-504) and his shorts as $168,740.12 (R504) for a total of $208,196.88. (R506). Deducting 30% of this, he arrived at a deduction of $62,459.06 (R506) which, when added to his reduction based upon aged fails to deliver of $5,058.22 (R506) and miscellaneous receivables of $475 (R506), came to a total deduction of $67,992.28 (R506). From this he subtracted Sloan's capital of $48,770.32 to arrive at a figure of $19,221.96. It can be seen that Taylor's haircut on Sloan's positions at the market far exceeded Sloan's net capital deficit. (R506). However, Taylor, following the standard procedure, computed the size of Sloan's security positions in terms of number of shares long and short on the trade date of June 23, 1971 and yet evaluated the market price of these security positions based upon market prices of June 30, 1971. Thus, any change, even a relatively small change, between the market prices on June 23, 1971 and June 30, 1971 could make it appear on paper that Sloan was in violation of the net capital rule on June 30, 1971 when Sloan was not actually in violation if he had sold his existing security positions and ac-

quired new positions in the intervening seven days. It should be added that Sloan was a market maker in all of the securities in which he had positions and the business of market makers is to buy and sell securities on a daily basis and to turn over security inventory rapidly. Thus, the suggestion of what might have happened had Sloan sold all of his security positions during the intervening seven days is not really hypothetical because this would normally be the case.

It must also be remembered that a fluctuation in the market price of a security compounds itself when net capital is computed, particularly on the short side. Thus, when the market value rises in a security in which Sloan is short, this increases Sloan's liabilities which in turn results in a direct deduction from capital. On top of that, 30% of the increased value of the short positions is deducted as a "haircut" from net capital. Thus, when Sloan is short a stock and the market value of that stock rises, his net capital is reduced by 130% of the increase in the market value. Conversely, when the market falls his net capital is increased by 130% of the fall. In this case, the claimed deficiency is $19,221.96. Dividing that by 130% one arrives at the figure of $14,786.08 which represents how much lower the market value of Sloan's shorts would have to be for him to be shown to be in compliance with the net capital rule, assuming the figures are otherwise correct. This works out to 8.76% of Sloan's short position which is less than the difference between the bid and the asked price in the case of most low priced over-the-counter stocks.

A market maker normally buys at the bid and sells at the asked. However, in computing the net capital of a market maker, the standard procedure is to value securities long at the bid and securities short at the asked. (A212). The rationale behind this is that if the market maker needs money and is forced to sell his positions to his competitors, the bid price would be the price he would get. Of course, that presumption is a fallacy as well because whenever

a market maker is forced to sell out his inventory, he usually knocks the market down. Also, if the market maker, or anyone else for that matter, has a large position to dispose of he can expect to get a much lower price than the bid price for his securities.

These points were discussed in the appellant's briefs filed in this court in S.E.C. v Fina Docket No. 73-2402 decided as 489 F. 2d 752 (2d Cir. 1974). That case involved violations of the net capital rule by a market maker which was ultimately liquidated by SIPC. This court did not write an opinion in that case, presumably because of the failure of the appellants to request the district court to make findings of fact. However, the arguments presented there about the many things wrong with the S.E.C.'s net capital rule are correct and valid. Indeed, the inability of the S.E.C. to settle on a rule which is not completely irrational has necessitated the many subsequent changes in the net capital rule.

It should be pointed out that there are constitutional considerations here. For example, in the case at hand, Sloan knew on June 23, 1971 what his end of the month security positions would be. Even if he bought or sold securities on June 24, 1971 or thereafter, these trades would not settle until at least July 1, 1971 and hence would not affect Sloan's end of the month positions. However, on June 23, 1971 naturally Sloan did not and could not know what the market value would be of those securities when June 30, 1971 arrived. Thus, Sloan, and for that matter any other broker dealer with large security positions, would normally be forced to trade on June 24, 25, 28, 29, and 30, 1971, without having any way of computing whether or not he met the S.E.C.'s net capital requirement. In fact, the first day Sloan could possibly make a computation would by July 1, 1971 when the pink sheets showing the prices for June 30, 1971 would be published. Contacting brokers by telephone and asking them their prices on June 30, 1971 would not help Sloan because the only prices which are used by regulatory bodies, accountants and stock brokers are the

published pink sheet prices. A fairly recent Supreme Court decision requires the IRS to use these prices as well. See Commissioner v National Alfalfa-Dehydrating 417 U.S. 134 (1974). Of course, the pink sheets sometimes makes mistakes and publishes the wrong prices and many brokers, including Sloan, usually do not publish their prices in the pink sheets because of the operation of S.E.C. Rule 15c2-11, 17 CFR 240.15c2-11, and this circumstance raises a variety of other considerations. However, the ultimate point is that there is no way that a broker in Sloan's position can ever know that a particular transaction is legal at the time he makes the transaction because net capital is always computed on an ex post facto basis and is never computed and could not be computed under the rules on the basis of facts known to exist at a given moment. It should be obvious that in these circumstances the net capital rule as applied by the S.E.C. has deprived Sloan of his constitutional right to due process of law. See Connally v General Construction Co. 269 U.S. 385, 391 (1926).

On each of the nine dates on which Kanoff testified that Sloan did not meet the net capital requirements, the deficiency which Kanoff claimed was less than the 30% haircut of the sum of the longs and the shorts as deducted by Kanoff. It can thus be seen that a small change in the market or a small human error by Kanoff could make the difference in whether Sloan was regarded as being in compliance with the net capital rule. In addition, it can be observed that the S.E.C. does not allege that Sloan did not meet the S.E.C.'s net capital requirement on March 31, 1971 or on October 29, 1971 even though a chart offered into evidence by the S.E.C. shows that Kanoff computed Sloan's net capital on both dates. (R652).

Any finding that Sloan violated the net capital rule necessitates a showing not only that Sloan performed an act which violated the rule but that he did so wilfully. It is clear from the portions of Sloan's testimony in his deposition of January 21, 1972 which have been quoted previously, that he had

prepared a net capital computation which showed him to be in compliance with the net capital rule. Here, the S.E.C. has failed to show that Sloan knew or should have know that his computation was wrong and hence there can be no finding that Sloan wilfully violated the net capital rule. In fact, Kanoff himself testified that on some dates he accepted Sloan's valuations and on other dates he did not "as a matter of expediency." (A256). In the case of at least one date, Kanoff's interest in "expediency" made the difference in whether Sloan was regarded as being in compliance with the net capital rule. On a number of dates in late 1971, Kanoff valued Sloan's position in Shareholders Excalibre Investing at zero. (R607, 635, 643, 650). Sloan valued this stock at $8 per share and marked on the lists of security positions he submitted to Kanoff once a month "Foreigh stock" (R611) and "Luxembourg" (R646) in order to insure that Kanoff would not overlook it. Kanoff also marked "foreign" (R635) and "Foreign Stock Traded Luxembourg" (R650) on his capital computations and yet gave Sloan's position in Shareholders Excalibre Investing zero value. It so happens that Shareholders Excalibre Investing is one of the largest mutual funds in the world and is the most actively traded security on the Luxembourg Stock Exchange. When asked to explain why he gave it zero value, Kanoff testified (A254):

> "I asked a supervisor if I should bother looking into foreign pricings for it, and I believe since it was only worth $400 in total, I was told not to look."

However, after again explaining that it was "faster and more convenient" to compute Sloan's capital as he did, (A257), Kanoff admitted that had he given Sloan'securities, including principally Shareholders Excalibre Investing, their full value, Sloan's capital on January 31, 1972 would have been "right on the button" (A259) and would not have been in violation of the net capital rule. Indeed, in its brief in S.E.C. v Sloan & Co. Docket No. 74-1436, the S.E.C. abandoned the claim that Sloan was in violation of the net capital rule on January 31, 1972 and it clearly should do so here.

The S.E.C. has consistently interpreted its net capital rule as being being subject to a "doing business test." In other words, it is not illegal for a broker's capital to fall below $5,000. It is only if the broker "does business" at a time when his capital is less than that which is required that the rule has been violated. Thus, Taylor's main argument was that the S.E.C. has failed to show that Sloan did any business on the eleven dates in question. Since Taylor's argument was quite obviously correct, and since the S.E.C. failed to demonstrate that Sloan made even a single purchase or sale of a security during the thirteen month period in question it is obvious that the findings of the S.E.C. with respect to net capital violations must be set aside. cf. Blue Chip Stamps v Manor Drug Stores 421 U.S. 723 (1975).

It should be noted that the S.E.C. does not disagree with Taylor's "doing business" analysis. It states, however (A54):

> "But Sloan's own testimony shows that he engaged in the securities business in the usual unrestricted sense from January to July 28, 1971"

This explanation evidently refers to Sloan's testimony at A297. A reading of that page, however, demonstrates that Sloan's testimony was far from sufficient to arrive at the conclusion reached by the S.E.C. The next sentence of the S.E.C.'s decision is erroneous as well. It says that Sloan "inserted quotations" in the pink sheets. The S.E.C. did not prove this fact. It sought to prove it by impeaching Sloan through the use of his prior testimony. (A299-319). This was clearly improper and proved nothing. The S.E.C. attorney continuously badgered and harassed Sloan in an effort to induce him to answer, in October, 1972, questions concerning whether he had submitted a particular card to the pink sheets on a particular date in January, 1972. If the S.E.C. wanted to prove that Sloan published a quote in the pink sheets in January, 1972, it had only to produce copy of the pink sheets with a quote listed next to Sloan's name, assuming one exists. The S.E.C. did not do this and again in its brief in S.E.C. v Sloan & Co. 74-1436 abandoned Judge Ward's finding #27(k) that

Sloan had published bid and asked quotations in the pink sheets. The only testimony in the record here on which the S.E.C. could possibly place any reliance is on A299 and with respect to Sloan's testimony there it should be noted that in Rothchild Securities Corp. CCH Fed. Sec. Law Rep. ¶79,693 [1973-74 Transfer Binder] (Securities and Exchange Commission Division of Market Regulation, January 27, 1974) it was made clear that "offer wanted," "bid wanted" and "name only" insertions in the pink sheets are not considered to be quotations within the meaning of Section 15(c) of the Securities Exchange Act. Thus it is apparent that the S.E.C.'s finding that Sloan "inserted quotations" in January, 1972 is clearly erroneous and must be set aside. Moreover, since this finding is an essential element in the S.E.C.'s finding that Sloan violated the net capital rule in January, 1972, that finding as well must be set aside.

It seems from the decision that the S.E.C. accepted Taylor's "doing business" analysis and consequently made no finding that Sloan violated the net capital rule in the months of August through December, 1971. It could not have made such findings in any event because Kanoff and the S.E.C. attorney admitted that all of Kanoff's computations for those dates contained errors and consequently had to be adjusted. (A185-186). In addition, on cross, Kanoff admitted that he had failed to give Sloan credit for 330 American Raceway and 300 Brooklyn Poly (A248), worth about $1,500 (A250), because of a "washed out blotter" (A249) which proved to be due to a photocopy error by the S.E.C. Kanoff later again admitted that he had "missed" the items (A261). On redirect, Rashes attempted to rationalize the error by showing that if the error were corrected Sloan would still not meet the net capital requirement. (A284-285). However, the fact that Kanoff admitted that he had made errors in six of the nine capital computations he prepared which were received in evidence plus the fact that even after adjusting for earlier errors, the August 31, 1971 computation contained at least this one confessed error, should be sufficient to demonstrate that none of the net capital computations prepared by Kanoff had any probative value. It should also be noted that even though Kanoff ad-

mitted that he made an error in computing Sloan's capital for August 31, 1971, no attempt was made to correct this error when the identical net capital computation was offered into evidence in the trial before Judge Ward.[6]

At this point the only question which remains is whether it can be said that Sloan violated the net capital rule in either June or July, 1971. However, the S.E.C.'s reference to the July date (A54) seems to be due to an oversight. It is clear from the decision that the S.E.C. accepted Taylor's argument that because of what was agreed to in a meeting between Sloan and the S.E.C.'s staff on July 28, 1971, there can be no finding that Sloan wilfully violated the net capital rule during the period immediately following. However, the July computation bears a date of July 31, 1971, or three days after the July 28, 1971 meeting, and it is necessary to conclude that the S.E.C. must have overlooked that fact and did not intend to find a violation on July 31, 1971. In any event, the record establishes that on July 28, 1971 Sloan, Taylor and Weiss did meet with the S.E.C. staff and thereafter Sloan submitted a variety of materials, many of which are part of the record here, and cooperated with the S.E.C. staff in every conceivable way and hence there can be no finding that Sloan wilfully violated the net capital rule on July 31, 1971.

In footnote 12 of its decision, the S.E.C. states that "Respondent admits that his net capital was deficient...." However, the quotation which follows is not something which was said by the respondent, Sloan, but rather apparently reflects what was said by Sloan's account. Clearly, this statement was not in the order of a concession which binds Sloan. It should be remembered that to be qualified to file a certified financial statement with the S.E.C., an accountant

6. In filing the record with this court, the S.E.C. seeks to cover-up Kanoff's error by leaving the "washed out blotter" out of the evidence. However, it can be seen by comparing R601 with R607-608 that Sloan submitted an August 31, 1971 trial balance to the S.E.C. which is stamped "Sec. and Exch. Comm. N.Y. Regional Office Received September 7, 1971" and which lists Sloan's long position as including 330 American Raceways and 300 Brooklyn Poly valued at $1,676.25 and that Kanoff failed to include these two security positions in his computation of Sloan's net capital.

must demonstrate his independence and it is particularly true in this case that Sloan's accountant cannot be regarded as Sloan's alter-ego because Sloan's accountant was in fact selected by the S.E.C.

However, the statement which the S.E.C. is quoting is placed in an improper context. On July 29, 1971, Taylor filed his X17A-5 report as of June 30, 1971 with the S.E.C. This X-17A-5 report, which, of course, included a net capital computation, showed Sloan to have a net capital deficiency on June 30, 1971. Thus, what Taylor said concerning net capital deficiencies with regard to July 28, 1971 meeting obviously was based on his computation of Sloan's capital as of June 30, 1971 since there is nothing in the record which shows that Taylor or anyone else computed Sloan's net capital as of any date between June 30, 1971 and July 28, 1971. Thus, if it can be shown that Sloan did not and could not have wilfully violated the net capital rule on June 30, 1971, the statement which the S.E.C. quotes in its decision is void of any meaning. In this case, it is obvious that Sloan did not wilfully violate the net capital rule on June 30, 1971. As noted previously, Sloan was subject to a temporary restraining order which was in effect from June 21, 1971 until Jule 24, 1971. This temporary restraining order prohibited Sloan from making any purchases and sales of securities. The S.E.C. has never suggested and there is no evidence to show that Sloan violated this temporary restraining order. As noted previously, the June 30, 1971 trial balance would reflect trading activity by Sloan up to and including the date of June 23, 1971 and would not reflect/any trading activity by Sloan after that date. However, on June 23, 1971, Sloan's trading position was frozen and he did not and could not buy or sell any securities. Indeed, Sloan spent the morning of June 23, 1971 in Judge McLean's court and the transcript of the proceedings of that day can be found in the appendix of <u>S.E.C.</u> v <u>Sloan & Co.</u> No. 74-1436. Nothing that Sloan did or could have done from June 24, 1971 until June 30, 1971 could have any material bearing on Sloan's net capital position because, due to the fallaceous way in which the S.E.C. requires that net capital be computed, the position is computed as of

the trade date whereas the market price is computed as of the settlement date. Thus, from June 21, 1971, the first day of the temporary restraining order, until June 30, 1971 Sloan was at the mercy of the market. If the market had gone Sloan's way during the intervening nine days, Taylor's computation would have shown Sloan to meet the net capital requirements. If the market had gone the other way, Taylor's computation would have shown a deficiency. But the main point is that nothing that Sloan himself did or could have done would have made any difference. Accordingly, there can be no finding that Sloan wilfully violated the net capital rule on June 30, 1971.

From the foregoing analysis of the evidence in the record, it is apparent that no showing has been or can be made that Sloan wilfully violated the net capital rule on any of the eleven dates listed in the decision of the S.E.C. and accordingly the findings of the S.E.C. must be set aside.

D

THE FINDINGS OF THE SECURITIES AND EXCHANGE COMMISSION THAT THE PETITIONER WILFULLY VIOLATED THE REPORTING REQUIREMENTS ARE NOT SUPPORTED BY SUBSTANTIAL EVIDENCE.

The S.E.C. devotes exactly two sentences and two footnotes of its decision to the finding that Sloan violated the reporting requirements. One gets the unmistakable impression that this is a tag-along allegation which was added for cosmetic purposes. As noted previously, in the parallel court case, the S.E.C. did not allege violations of any of the three reporting rules it claims here that Sloan violated. Moreover, the record here contains no evidence that Sloan violated any of these rules. In fact, during the course of the administrative hearing, the attorney for the S.E.C. disavowed any allegation that there was a failure by Sloan to file his 1970 X-17A-5 report (A387). In addition, Kanoff testified that his understanding was that the 1970 late filing or non-filing was not going to be made an issue (A269) and that "the entire situation with the Sloan firm was hinging upon his capital position, rather

than the matter of filings being late or not" (A270). Apparently,Kanoff concluded that the January, 1971 filing was being accepted for the 1970 filing (A269). He was in a position to know, since he was assigned to analyze that filing (A272). In addition, the conclusion that the January, 1971 filing was accepted for the 1970 filing was reasonable and logical considering the facts and circumstances of this case. Sloan testified that he hired an accountant by the name of Martin London of the New York accounting firm of Lader, Scheps & London to prepare his 1970 annual X-17A-5 report (A383) and that London had prepared a report as of the date of September 25, 1970 (A383). However, Sloan also testified that Mr. Jaffee, one of the many S.E.C. attorneys who got involved in this case at one time or another, told him that the report prepared by London could not be filed because, unknown to Sloan, London, in addition to being an accountant, was a partner in another brokerage firm. (A383). It turns out that there is an obscure S.E.C. interpretation of the word "independent," which Sloan did not and could not have been expected to know about, which provides that any accountant working for or associated with a brokerage firm is, ipso facto, disqualified as acting as an independent public accountant for another brokerage firm. However, by the time Sloan found this out, London had already prepared his report and since London obtained every possible extention and had procrastinated until the last possible moment in submitting his report which Sloan attempted to file, it was already approaching the beginning of 1971 when Sloan finally learned that London's report was unacceptable to the S.E.C. (A384).

Sloan then hastened to hire a new accountant. However, Mr. Jaffee of the S.E.C. told Sloan to file a report as of the most current date possible rather than as of a date in 1970 (A385). Sloan did this and hence the report which Sloan filed was as of the date of January 29, 1971 which Kanoff reasonably concluded was being accepted for the 1970 filing. It should be noted that at the hearing, the S.E.C. attorney did not dispute these facts and by his silence admitted them to be true, especially since Sloan testified that Mr. Rashes as

well as Mr. Jaffee was involved in these discussions. (A385).

Turning to the question of whether, assuming that there was a violation, the violation was wilful, it can be seen that over a period of less than a year, Sloan hired and paid three accountants to prepare an X-17A-5 report but that two of these reports were rejected by the S.E.C. on arbitrary and unreasonable grounds. It is obvious that the finding by the S.E.C. that there was a violation of Rule 17a-5 rests upon the correctness of rejecting these two X-17A-5 filings. It is also obvious that the S.E.C.'s refusal to accept London's X-17A-5 was arbitrary and unreasonable.[7] There is nothing in Rule 17a-5 which says that a certified public accountant who happens to be a partner in a stock brokerage firm cannot file an X-17A-5 report on behalf of another brokerage firm with which he has no connection. The S.E.C.'s supposed administrative interpretation of its own rule notwithstanding, Sloan understandably had a "false sense of security," Bouie v Columbia 378 U.S. 347, 352 (1964), because he had every reason to believe that London's report would be acceptable to the S.E.C. Hence, there can be no finding that Sloan wilfully violated Rule 17a-5.

Taylor filed an X-17A-5 report for 1971 but again this was not accepted as such by the S.E.C. Rashes explained that this was primarily because it was prepared pursuant to an injunction (A205). Even the administrative law judge, who generally agreed with everything Rashes said, could not accept this explanation (A145, A204). The report was in form and substance an X-17A-5 report and the report itself and its covering letter stated that it was an X-17A-5 report (R507, R510). Moreover, the S.E.C. sent Taylor a letter acknowledging receipt of an X-17A-5 report which took no exception to the filing of that report (A198-199). In addition, the S.E.C. did not notify either Sloan or Taylor of its decision not to accept Taylor's filing as an X-17A-5

7. The document Sloan sought to file is one of the exhibits in the record of S.E.C. v Sloan & Co. 74-1436.

report (A199). In short, the failure of the S.E.C. to accept Sloan's X-17A-5 filing was arbitrary, irrational and illegal and there can be no finding that Sloan wilfully violated S.E.C. Rule 17a-5 since it is apparent that in reality the S.E.C. violated its own rule.

Turning next to the finding that Sloan violated Rule 17a-10, the decision states that:

> "Although it was required to be filed by April 1971, respondent says he did not do so until December, 1971."

Actually, the respondent said nothing of the kind. The respondent's answer denied the allegation that the X-17A-10 report had wilfully been filed late and stated that the report was filed and accepted by the Commission, prior to the date of the Order for Public Proceedings (A402).

At the administrative hearing, the question of the filing or non-filing of the X-17A-10 report never came up. No evidence was introduced by the S.E.C. regarding the alleged failure to file this report. It simply was not mentioned and apparently was forgotten during the course of the hearing. Under these circumstances, there can be no finding on the record here that Sloan wilfully violated the rule or indeed that he violated the rule at all.

It must be remembered that in passing Sections 15(b)(5) and 15(b)(7) of the Securities Exchange Act of 1934, which have since been renumbered §15(b)(4) and 15(b)(6) respectively, Congress provided that remedial sanctions may not be imposed unless there has been a showing that (1) a statute or a rule has been violated (2) this violation was wilful and (3) the public interest requires the imposition of penalties. In the case of a question of whether a particular report has been filed or not filed, there would in most cases be no need for a hearing were it not for the due process requirements of part two and three above. Congress or the S.E.C. could, for example, provide for an automatic sixty day suspension in the case of the late filing of an X-17A-10 report. Since Congress has not done so and since the S.E.C. did not see fit to prove

its case or even to bring up at the hearing Sloan's alleged failure to file an X-17A-10 report, it is clear that the findings of the S.E.C. must be set aside.

All then that remains is the finding, which was relegated to a footnote in the S.E.C.'s decision (A55 n. 17), that Sloan wilfully violated Rule 17a-11. What has just been said about the alleged failure to file the X-17A-10 report applies here as well. Sloan's supposed failure to send a telegram to the S.E.C. in accordance with Rule 17a-11 was not even mentioned at the hearing and no proof was offered. Hence, no findings can be made and the findings that the S.E.C. did make must be set aside.

The S.E.C.'s decision states (A55 n. 17): "And no exception has been taken to this finding." Apparently, the S.E.C. feels that Taylor was required to go through every word of the administrative law judge's 24 page opinion (A35048) and to point out in laborious detail his many errors.[8] However, in order to make a finding that Sloan violated Rule 17a-11, it must first be shown that Sloan violated Rule 15c 3-1 because Rule 17a-11 provides that on the date that a violation of Rule 15c3-1 first occurs, a broker must send the S.E.C. a telegram notifying the S.E.C. of this fact. Therefore, Taylor quite appropriately addressed himself to the point that Sloan did not violate Rule 15c3-1 because, among other things, the S.E.C.'s proposed findings of fact that Sloan did business in July, August and September, 1971 was not supported by substantial evidence and was contrary to the weight of the evidence. It appears that the S.E.C. agreed with this analysis and did not find that Sloan violated Rule 15c3-1 in September, 1971. Accordingly, the finding that he violated Rule 17a-11 must fall as well.

8. Had the S.E.C. not refused to permit Taylor to make a photocopy of the transcript, he would have been in a better position to do this. In any event, the burden is on the S.E.C. to prove its case, not on Taylor to refute it.

It should be noted that the S.E.C. finds that Sloan violated Rule 17a-11 on September 15, 1971, the date on which the rule came into effect. Apparently, the S.E.C. contends that Sloan should have sent the S.E.C. a telegram notifying the S.E.C. of the effectiveness of its new rule. There is nothing in the record to indicate that September 15, 1971 was the date that Sloan first violated the net capital rule. For all the record discloses, Sloan could have been in Timbukto or in Iceland or at home in bed on that date. In addition, the record establishes that Sloan was already filing a variety of financial data in response to continuing requests by the S.E.C. Under these circumstances, there was no reason to expect or to require Sloan to send a telegram to the S.E.C. and the S.E.C.'s claim that Sloan wilfully violated Rule 17a-11 is frivolous.

It should also be pointed out that Rule 17a-11 is obviously unconstitutional on its face in accordance with Supreme Court decisions of Leary v United States 395 U.S. 6 (1969) and Haynes v United States 390 U.S. 85 (1968). These decisions establish that any federal law which requires, in effect, that an individual notify the government that he has violated another state or federal law, is unconstitutional in that it results in a deprivation of the Fifth Amendment guarantee against self-incrimination. Clearly, Rule 17a-11 is unconstitutional under the so-called "Leary rule" and this court should not hesitate to strike it down.

E

THE FINDINGS OF THE SECURITIES AND EXCHANGE COMMISSION CONCERNING THE ENTRY OF AN INJUNCTION ARE NOT SUPPORTED BY EVIDENCE IN THE RECORD AND MUST BE SET ASIDE.

The decision of the S.E.C. refers to an injunction (A55). Nothing in the record of the administrative hearing, which took place in 1972, contains any evidence concerning this injunction, which was entered in 1974. Accordingly these findings of the S.E.C. must be set aside.

This result is required by the Fifth Amendment and by the Administrative

Procedure Act, 5 U.S.C. §556(d), which states that:

> "a sanction may not be imposed..... except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence."

This provision, it should be added, prohibits the S.E.C. from making findings "upon an independent review of the record" as it says it did here. (A51 n.2).

The decision also refers off-handedly to a preliminary injunction which was alleged in the order for public proceedings. However, by now it should be obvious that Sloan was coerced into consenting to this preliminary injunction. The deal, which the S.E.C. attorney did not try to hide in arguing this point before Judge McLean on June 23, 1971, was that if Sloan would "consent" to an injunction, the S.E.C. would permit Sloan's bank to return to Sloan the $34,999.03 which the S.E.C. had frozen through its temporary restraining order. What is involved here is analogous to decided cases involving circumstances where a criminal defendant confesses his guilt after being given the "third degree" by local police offiers. The Constitution requires that confessions of this sort are not admissible in evidence.

It is also clear that the S.E.C. obtained the temporary restraining order and the subsequent preliminary injunction by corruption and fraud. The S.E.C. has presented its entire case against Sloan here, and it can be seen that the S.E.C. does not now and has never had any case against Sloan. By reading and comparing the S.E.C.'s presentation here to what was alleged in the affidavits and memorandums filed by the S.E.C. in support of its motion dated June 18, 1971 for a preliminary injunction and a temporary restraining order, it can be seen that the S.E.C.'s allegations in the court case were a fraud and a sham. Accordingly, the S.E.C. cannot be permitted to enjoy the forbidden fruits obtained by its illegal activities.

Finally, the S.E.C. acts improperly by referring in footnote 19 of its

decision to findings of fact made by Judge Ward in the parallel civil suit (A55). The purpose of findings of fact is to aid appellate review, Lemelson v Kellogg Company 440 F. 2d 986, 988 (2d Cir. 1971) and to avoid prejudice to the parties, Leighton v One William Street Fund, Inc. 343 F. 2d 565, 567 (2d Cir. 1965). Such findings may not be used as prima facie evidence in another case. Accordingly, the findings in footnote 19 of the S.E.C.'s decision must be set aside.

F

THE FINDINGS OF THE SECURITIES AND EXCHANGE COMMISSION THAT THE IMPOSITION OF REMEDIAL SANCTIONS IS IN THE PUBLIC INTEREST IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE AND MUST BE SET ASIDE.

The decision of the S.E.C. expresses a curious view of what constitutes the public interest. It's section dealing with public interest is devoted exclusively to a discussion of judicial proceedings which took place after the administrative hearing (A56-58). Obviously, the public at large has no interest in these proceedings. For example, the decision quotes at length from papers filed by Sloan which criticized the way Judge Ward was conducting his case (A57-58). It is true that Sloan attempted to mandamus Judge Ward but the only person with a direct interest in the outcome of Sloan's petition for a writ of mandamus was Judge Ward himself. The S.E.C. did not appear and oppose Sloan's petition and the public had no economic interest in the outcome.

Its decision makes it clear that the S.E.C. confuses the interests of the S.E.C. with the interests of the public.[9] It is obvious that the real reason that the S.E.C. is imposing the severest of penalties on Sloan is that Sloan has dared to challenge the S.E.C. in court instead of docilely "consenting" to the imposition of injunctions and other penalties. In many cases brokers whose firms have gone into bankruptcy or into SIPC receivorship and who have cost the

9. One is reminded of the saying from Little Abner, "What's good for General Bullmoose, is good for the U.S.A."

public or the federal government millions of dollars have gotten away free or with only so much as a "slap on the wrist." However, the uncontested testimony here was that Sloan had always paid his debts, that he had never defaulted on a securities transaction, and that any customers his firm may have had always received their monies or securities. (A388). If this could be said of every broker, there would be no need for a Securities Exchange Act.

The record here indicates that the only person who suffered injury because of the events and circumstances involved in this proceeding was Sloan himself. Sloan testified that he lost in the vicinity of $30,000 because of his July 28, 1971 agreement which required in effect that he close Sloan & Co. which in turn prevented him from defending his trading positions with result that he was bought -in on most of the securities he had sold short. (A378-379). Anyone familiar with the securities business knows that being bought-in on a short position of $147,000 (R590) would normally result in a loss of at least $30,000. Thus, Judge Tracy's characterization of Sloan's testimony as "merely a projection" and "self-serving" demonstrates nothing more than the willingness of the S.E.C. to belittle attempts by Sloan to make a "true and full disclosure of the facts." See Administrative Procedure Act, 5 U.S.C. §556(d).

It can be seen from the evidence presented in this case that Sloan's overall loss was actually more than $30,000 as demonstrated by the steady shrinkage of his overall capital in computations submitted from June, 1971 until January, 1972. Moreover, it is clear from the record here that in hindsight Sloan would have been better off by staying in business and spending the $30,000 he lost in going out of business in legal fees. Sloan obviously believed that the S.E.C. attorneys would recognize the extreme measures he had taken in the interest of cooperating with the S.E.C. and that he would not be prosecuted further. This of course, has proven to be hardly the case.

In short, the findings of the S.E.C. with regard to "public interest" are clearly erroneous and must be set aside. It should be added here that in the

Securities Exchange Act Congress has established that unless there is appropriate finding of "public interest," no remedial sanctions may be imposed. Accordingly, on this point alone, the order of the S.E.C. must be vacated.

POINT IV

THE RECORD HERE DOES NOT SUPPORT A FINDING OR A CONCLUSION THAT THE PETITIONER WILFULLY VIOLATED ANY STATUTE OR RULE.

"Wilful" has been called a word "of many meanings, its construction often being influenced by its context." Spies v United States 317 U.S. 492, 497 (1943). When used in a criminal context, "it generally means an act done with a bad purpose." United States v Murdock 290 U.S. 389, 394 (1933). The definition of "wilful" applied by the S.E.C. in this case would, if allowed, strip the word, which Congress wilfully wrote into the statute, of any meaning.

The S.E.C.'s decision does not turn on anything that Sloan himself did. Rather, it refers to the fact that Bruder and Kanoff visited Sloan's office and recites what it finds that they observed. The decision states that Kanoff observed "debit and credit slips" (A53), for example. None of this tells anything about what Sloan himself did. Accordingly, no finding can be made that Sloan wilfully did anything even under the definition quoted in footnote 14 of the S.E.C.'s decision.

To the extent that it finds anything, the findings of the S.E.C. concern what Sloan did not do as opposed to what he did do. The S.E.C. alleges that he failed to keep books and that he failed to file reports with the S.E.C. With regard to the late filing or non-filing of reports, the S.E.C. must show that Sloan knew that he was required to file these reports and that he closed his eyes to this fact. In the X-17A-10 report, it is obvious that Sloan did not know sooner that he was required to file it. Sloan had employed and paid three certified public accountants to prepare and file his S.E.C. reports and he had no reason to believe that they had all overlooked something and that

there was an additional report which needed to be filed. Moreover, there has been and can be no showing that Sloan wilfully violated the net capital rule since due to the way that net capital is computed, a broker cannot know that the net capital rule has been violated until long after the violation has occurred. Accordingly, the findings of the S.E.C. concerning wilfullness must be set aside.

In addition, in Ernst & Ernst v Hochfelder 44 U.S.L.W. 4451 (March 31, 1976) the Supreme Court established that in order to demonstrate an actionable violation of the Securities Exchange Act there must be a showing of more than mere negligence. That decision involved Rule 17a-5, which is also involved here. To be sure a number of footnotes to that decision stated that the Supreme Court was not then deciding certain questions directly relevant to a determination of the case here. Nevertheless, that decision leaves little doubt that under the circumstances of the case at the bar, the S.E.C. cannot prevail.

POINT V

THE PETITIONER HAS BEEN STRIPPED OF HIS FOURTH AND FIFTH AMENDMENT CONSTITUTIONAL RIGHTS IN THIS PROCEEDING AND HIS FIRST AMENDMENT CONSTITUTIONAL RIGHTS HAVE BEEN UNCONSTITUTIONALLY CHILLED BY FEAR OF RETALIATION FROM THE SECURITIES AND EXCHANGE COMMISSION.

Due to the extended discussion of evidentiary matters which has been necessary here, the petitioner is now required to be extraordinarily brief in setting forth certain important constitutional arguments. However, since there can be no doubt that the judges of this court have read and are familiar with the Constitution, it is hoped that the gaps in this argument can be filled if necessary.

It is submitted that the petitioner has been stripped of his Fourth and Fifth Amendment Constitutional rights as well as his First Amendment right to petition the government for a redress of grievances and that this court must do as much as it can to make Sloan whole by setting aside the decision and

order of the S.E.C.[10] The cases to consider on this point are Garrity v New Jersey 385 U.S. 493 (1967); Spevak v Klein 385 U.S. 511 (1967); Boyd v United States 116 U.S. 616 (1886) and See v City of Seattle 387 U.S. 541 (1967).

A lengthy analysis of these Supreme Court decisions will not be made here because they are well known and their application to the case at the bar is obvious. In this case, two S.E.C. investigators, Bruder and Kanoff, have been given unlimited access to Sloan's office and have been allowed to rummage through his papers at will. Clearly, Sloan was deprived of his Fourth Amendment rights in this process. Nevertheless, Sloan did not protest and, to the contrary, when these two investigators became too lazy to come to his office to examine his records, Sloan was more than willing to submit all manner and variety of financial data to the S.E.C. The reason that Sloan did this was obviously because he feared retaliation from the Securities & Exchange Commission if he did otherwise. Clearly, his fears were well founded. In spite of the extreme lengths to which Sloan went to cooperate, the administrative law judge, under the heading "public interest," cited"Sloan's uncooperative attitude" (A47) and although the S.E.C. itself did not make any findings in this regard there can be no doubt that the policy of the S.E.C. is to punish any person whom it considers not to be sufficiently cooperative with the S.E.C. Indeed, in a more recent case, S.E.C. v Sloan 74 Civil 5729, the S.E.C. has repeatedly cited in papers and briefs filed in the district court and in this court Sloan's alleged statement that he "was not particularly inclined to cooperate with the Commission." See e.g. Brief for S.E.C. p. 3 in S.E.C. v Sloan 75-6106, slip op. 3655. It is thus clear that the S.E.C. regards a lack of co-

10. The S.E.C.'s decision observes that Sloan is contesting the constitutionality of this proceeding as well as of the Exchange Act as a whole (A56 n. 23) but then cites three cases which are not even concerned with constitutional law. The clear irrelevance of those three cases makes a detailed discussion of them inappropriate here.

operative zeal to be a punishable offense deserving of retaliation.

Many of the documents offered into evidence in this case by the S.E.C. are documents prepared by Sloan's own hand which the S.E.C. obtained during the course of depriving Sloan of his Fourth and Fifth Amendment constitutional rights. Under these circumstances, Garrity v New Jersey and the other Supreme Court decisions cited previously require that the order of the S.E.C. be set aside.

POINT VI

THE ORDER OF THE SECURITIES AND EXCHANGE COMMISSION MUST BE SET ASIDE BECAUSE THE RISK OF BIAS IN THIS PROCEEDING IS TOO HIGH TO BE CONSTITUTIONALLY TOLERABLE.

If, during a trial in a court case, the judge ever went out to lunch with the prosecuting attorney, the defense counsel would no doubt be understandably upset. Yet this happens all the time in administrative proceedings before the S.E.C. Here, in an affidavit filed by Sloan in November, 1973 in S.E.C. v Sloan & Co. 71 Civil 5729 and paragraph 29, p. 14 of another affidavit filed by Sloan with the S.E.C. dated December 8, 1975 in a motion for leave to adduce additional evidence and other relief, Sloan described a conversation he overheard in August, 1973 between Kanoff and his co-worker, Administrative Law Judge Tracy, in which this case was discussed. According to Sloan's affidavit, Tracy asked Kanoff, "How did you like the part where I said that I believed you?" Sloan's account of this conversation has not been denied by the S.E.C. and it can be observed that Judge Tracy's decision stated that the testimony of Kanoff and Bruder was "credible and worthy of belief" (A39) whereas Sloan's was "not worthy of belief." (A43).

In Withrow v Larkin 421 U.S. 35, 46-47 (1975) the Supreme Court set forth a variety of circumstances where the risk of bias in a proceeding is too high to be constitutionally tolerable. It is obvious that the case at the

bar is one of them.[11] Administrative proceedings before the S.E.C. are well known to be kangeroo courts to anyone who has been involved in them. In fact, Administrative Law Judge Ralph Hunter Tracy has never,in his entire career as an administrative law judge, ruled in favor of a respondent. It can be seen from the record here that the judicial principles applied in this case could well have been taken directly from "The Trial" by Franz Kafka.

It is also obvious that the reason the S.E.C. has seen fit here to impose the severest penalties upon Sloan based upon one of the weakest cases imaginable is directly related to the fact that Sloan has seen fit to challenge the power and authority of the S.E.C. in court and a number of S.E.C. attorneys have been called upon to devote their full efforts to prosecuting Sloan. Thus, the Commissioners have an obligation to their own staff to vindicate their efforts by punishing Sloan even in circumstances where punishment is not warranted.

It should be noted that by imposing sanctions on Sloan, the S.E.C. is protecting its own staff. The decision states that Sloan's charges of unprofessional conduct on the part of the S.E.C. staff are "irrelevant." (A55 n.20). This is not true because Sloan's charges relate directly to the truth of the allegations made in the administrative proceeding, (see e.g. A426-427), and to the fact that Sloan contends that this administrative proceeding was commenced illegally because its purpose was to retaliate for Sloan's refusal to consent to have the preliminary injunction made permanent in the parallel court case (A430). Thus, Sloan contends that this case involves selective prosecution which again is not permitted by the Constitution. Lennon v INS 527 F. 2d 187, 195 (2d Cir. 1975). It should be noted that when Sloan made the same allegations of unprofessional conduct to Judge Ward, the court ruled:

> "[T]he claim of alleged improper conduct of the S.E.C. attorney handling the case should in the first instance be presented to the Commission." Decision of November 20, 1973,p. 9.

11. It should be noted that Withrow v Larkin was concerned a state licensing proceeding where the constitutional doctrine of separation of powers does not apply as opposed to the federal proceedings here.

Sloan has since presented his claims to the S.E.C. but the S.E.C. has refused to consider them. The total effect has been to shut the door to any attempts by Sloan to demonstrate illegal conduct on the part of various S.E.C. attorneys. This should not be permitted. cf. United States v Rosner 516 F. 2d 269, 272 (2d Cir. 1975).

It has recently been rumored in the financial press that many high level departures from the S.E.C. staff have been the result of the appointment of a new Chairman, Roderick M. Hills, and the departure of former Chairman Garrett and Commissioner Sommer, who were two of the most repressive Commissioners in the history of the S.E.C. Whether this rumor is true is not directly relevant here but it serves to illustrate the point that the S.E.C. commissioners owe a certain duty to their staff to vindicate their authority and to back them up in a contested case. The obvious reality of this consideration again demonstrates the unconstitutionality of this proceeding. It is also worth mentioning that Sloan is to a great extent the victim of bad luck. The Commissioners who were in office at the time this proceeding was commenced were more lenient with regard to net capital violations even in cases where the broker dealer in question went into bankruptcy. See e.g. In the Matter of Taliaferro and Ostrow Exchange Act Release No. 9871 (November 27, 1972) CCH Fed. Sec. Law Rep. ¶79,142 [1972-73 Transfer Binder]. Moreover, in the few months that Hills has been chairman, a surprising number of proceedings have been dismissed or, in the alternative, no remedial sanctions have been imposed.[12] However, the appointment of Hills came too late to be of any benefit to Sloan and the decision here came near the height of repressive actions by the S.E.C. where in some cases brokers were severely penalized for events which had occurred ten years earlier. Again, the fact that the office of S.E.C. Commissioner is political rather than judicial in character and the fact that the power to impose the sanctions imposed here invites political abuse demonstrates the un-

12. This is really not too surprising. In his Senate confirmation hearings, Hills testified sarcastically that the symbol of the S.E.C. should be changed from an eagle to a buzzard and the new motto of the S.E.C. should be: "We pick 'em clean."

constitutionality of this proceeding. cf. Ward v Village of Monroeville 409 U.S. 57, 60 (1972). Since the proceeding is unconstitutional, the order of the S.E.C. must be set aside.

POINT VII

THE ORDER OF THE SECURITIES AND EXCHANGE COMMISSION MUST BE SET ASIDE BECAUSE THE PENALTY IS MORE SEVERE THAN THAT PERMITTED BY STATUTE.

Section 15(b)(6) of the Securities Exchange Act at the time of the decision of April 28, 1975 provided:

> "The Commission may....by order censure....or bar or suspend for a period not exceeding twelve months any person from being associated with any broker or dealer......"

This section can be read two ways and the S.E.C. apparently believes that it gives the S.E.C. the power to bar a person for the rest of his life. This interpretation cannot be permitted.

As a matter of statutory construction, this section must be interpreted as giving the S.E.C. the power "to bar,,,,for a period not exceeding twelve months any person....." A bar for life would be entirely punitive and is not permitted by the constitution. Cummings v Missouri 71 U.S. (4 Wall) 277, 320-322 (1866); Ex parte Garland 71 U.S. (4 Wall) 333, 380-381 (1866) and United States v Lovett 328 U.S. 303, 314 (1946). It should be noted that Sloan was only 28 at the time of the administrative hearing (R286) and a bar for life would be horrendous in view of Sloan's tender years.

In this case, more than twelve months have now passed since the S.E.C. entered its order imposing remedial sanctions and if this court agrees with this construction, the order should be set aside forthwith.

POINT VIII

THE SECURITIES AND EXCHANGE COMMISSION LACKED JURISDICTION BECAUSE NO SHOWING WAS MADE THAT THE PETITIONER PURCHASED OR SOLD SECURITIES EITHER IN INTERSTATE COMMERCE OR OTHERWISE.

In Blue Chip Stamps v Manor Drug Stores, supra the Supreme Court established the purchaser/seller requirement in any action brought under S.E.C. Rule 10b-5. That decision turned upon the "purchase and sale" language which can also be found in Section 15(c)(3) of the Securities Exchange Act. Thus, the S.E.C. must show an actual purchase or a sale of a security in connection with a violation of the net capital rule in order to prevail here. Although the purchase and sale language cannot be found in Section 17(a) of the Exchange Act or in the recordkeeping and reporting rules promulgated thereunder, it is obvious that if no securities were bought or sold there would be no records to keep and no reason to file reports and accordingly a violation of the recordkeeping and reporting rules would at best be governed by the principle of de minimis non curat **lex.** In the case at the bar, the S.E.C. has failed to allege or prove even a single purchase or sale of a security and consequently the order of the S.E.C. must be set aside.

It must be set aside as well on jurisdictional grounds. The S.E.C. has made no attempt to show that Sloan made use of the means or the instrumentalities of interstate commerce. The only time it comes close is when it refers to the pink sheets (A54) and it has already been demonstrated that the S.E.C. did not prove that Sloan published even a single quotation in the pink sheets. Moreover, even if the S.E.C.'s proof were sufficient, all that would be shown would be that Sloan published quotes in the pink sheets in January, 1972 and all of the findings by the S.E.C. concerning violations of various rules during 1971 would be required to be set aside since no casual connection could possibly be shown between for example Sloan's alleged failure to keep books in early 1971 and his publication of quotes in the pink sheets in 1972.

POINT IX

THE CONDUCT OF THE ADMINISTRATIVE PROCEEDING BY AN ADMINISTRATIVE LAW JUDGE VIOLATES ARTICLE III, SECTION I OF THE UNITED STATES CONSTITUTION, DEPRIVES THE PETITIONER OF HIS SIXTH AND SEVENTH AMENDMENT CONSTITUTIONAL RIGHTS AND VIOLATES THE PRINCIPLES UPON WHICH THIS NATION WAS FOUNDED AS SET FORTH IN THE DECLARATION OF INDEPENDENCE.

The Declaration of Independence, in its listing of "repeated injuries and usurpations, all having in direct object the establishment of an obsolute tyrany over these states," said:

> "He has made judges dependent on his will alone, for the tenure of their offices, and the amount and payment of their salaries."

In order to prevent this situation from arising again, the Framers of the Constitution set forth in Article III, Section 1 the following:

> "The judges, both of the supreme and inferior Courts, shall hold their offices during good behavior....."

It is settled law that this means that all federal judges are appointed for life and may not be removed except by impeachment by Congress. Chandler v Judicial Council 398 U.S. 74, 141 (1970) (Black J., dissenting). Congress has agreed with the wisdom of this assessment and in the history of the United States has removed judges in only a handful of cases and even then only **in the most extraordinary of circumstances.**

Without getting involved in the details of how administrative law judges are hired and fired, it can safely be stated that an administrative law judge such as Ralph Hunter Tracy was not appointed for life and therefore cannot act as an Article III judge. A statutory point related to the Article III question was discussed in Amos Treat & Co. v S.E.C. 306 F. 2d 260 (D.C. Cir. 1962) and there an administrative law judge was held to be disqualified.

Here we have a broader constitutional question because Sloan has been judged twice; first by the administrative law judge and then by the Securities and Exchange Commissioners. The latter are clearly temporary political appointees and cannot judge under Article III. The Securities and Exchange Commissioners are appointed for a term of five years and in most recent instances

have not even completed their term of office. As noted previously, two of the four commissioners who decided this case against Sloan have since resigned from the S.E.C. These two commissioners were only with the S.E.C. for a little more than two years and it is clear that the decision here as well as others made by these commissioners were merely a stepping stone for the advancement of their political careers. This circumstance is precisely what Article III of the Constitution was designed to prevent and consequently the order entered here must be set aside.

In addition, this proceeding is repugnant to other provisions of the Constitution. For example, the S.E.C. characterizes this as a parallel proceeding, which it defends. See "Other Matters"(A55-56). Again, the Framers of the Constitution sought to prevent precisely the abuse of power which has occurred here. The Seventh Amendment provides that "no fact tried by a jury shall be otherwise re-examined in any court of the United States than according to the rules of common law." Moreover, the Fifth Amendment provides that "nor shall any person be subject for the same offense to be twice put in jeprody." It is obvious that the Framers of the Constitution considered it to be a matter of great importance that no person should be prosecuted and punished more than once for the same thing. Yet the S.E.C. expressly states that Sloan was sued in the federal courts for exactly the same reasons that the administrative proceeding here was brought. Although these proceedings are brought under the guise of equity, there can be no doubt that they are punitive in character, see Boyd v United States, supra, and hence are prohibited by the Constitution. It should be noted that the events which are the subject of the proceedings here occurred five years ago. It has already been demonstrated that the charges are totally unfounded. Yet the S.E.C. has succeeded in cutting five years out of Sloan's life which cannot be restored regardless of what this court decides, by its strategy of prosecuting parallel proceedings which has kept Sloan tied up endlessly in defense.

Sloan has also been deprived of his Sixth Amendment rights including the right to a speedy trial by an impartial jury. As Supreme Court Justice Stephen Field said in an analogous case, Cummings v Missouri, supra 71 U.S. (4 Wall) at 321-322:

> ".....in the pursuit of happiness all avocations, all honors, all positions, are alike open to every one, and that in the protection of these rights we are all equal before the law. Any deprivation or suspension of these rights for past conduct is punishment, and can be in no otherwise defined."

Since what is involved here is clearly punishment, Sloan was entitled to the rights guaranteed to him by the Sixth Amendment. **Since he was deprived of those rights, the order of the S.E.C. is an unconstitutional bill of attainder and must be set aside. United States v. Lovett, supra 328 U.S. at 315-318.**

POINT X

SECURITIES AND EXCHANGE COMMISSION RULES 15c 3-1, 17a-3, 17a-5, 17a-10 AND 17a-11 ARE UNCONSTITUTIONAL FACIALLY AND AS APPLIED IN THIS CASE.

A long line of Supreme Court decisions has established the constitutional right to hold specific private employment and to follow a chosen profession free from unreasonable governmental interference. See Greene v McElroy 360 U.S. 474, 492 (1959) and authorities there cited. Indeed it can be said that the freedom to engage in private enterprise is a constitutional concept, notwithstanding Justice Holmes' famous dissent in Lochner v New York 198 U.S. 45, 75 (1905).

Here, it is apparent that the S.E.C.'s net capital, recordkeeping, and reporting rules are irrational and unreasonable and hence are unconstitutional. If the allegations of the S.E.C. are to be believed, it would seem that Sloan has flagrantly disregarded six S.E.C. rules for a period of more than one year and yet no person suffered injury as a result. This alone should suffice to demonstrate the irrationality of the S.E.C.'s rules.

Turning to the specific rules in question, it has already been shown that Rule 17a-11 is unconstitutional under Leary v United States, supra and Haynes

v United States, supra and that Rule 15c 3-1 is unconstitutional under Connally v General Construction Co., supra and subsequent cases based upon the principle enunciated there. It has been seen that from an analysis of the way that net capital is actually computed, the net capital rule violates the familiar due process requirement of adequate notice and hence is unconstitutional. See e.g. Jordan v De George 341 U.S. 223, 230 (1951) rehearing denied 341 U.S. 956 (1951); Bouie v Columbia, supra 378 U.S. at 351; Coates v City of Cincinnati 402 U.S. 611, 614 (1971). All that remains, then, are the S.E.C.'s recordkeeping and reporting rules.

Congress may, of course, require business entities to keep records and make reports. United States v Morton Salt Co. 338 U.S. 632, 647-651 (1950). However, these reports must reasonably be related to a specific purpose. Shapiro v United States 335 U.S. 1, 32 (1948); Yakus v United States 321 U.S. 414, 424 (1944); United States v Darby 312 U.S. 100, 125 (1941). Here, however, no specific purpose has been or can be shown. For example, Rule 17a-10 requires an annual report of income and expense for the calendar year. The report required is nothing more than a one page fill-in-the-blanks type summary which has so little importance that the S.E.C. gives brokers 120 days to file it. There is no reason, other than general vexatiousness, for the S.E.C. to want to know the income and expense of a broker for the calendar year in view of the fact the report is of no aid in determining whether a broker is in compliance with any other S.E.C. rule, such as the net capital rule. Under these circumstances, Rule 17a-10 is unconstitutional.

Rule 17a-5 is also unconstitutional, but for a different reason. There can be no doubt that the report required by this rule has a specific purpose. However, the purpose is forbidden by the Constitution in that it undermines Fifth Amendment guarantee against self incrimination. From reading the X-17A-5 report, one can readily determine whether a broker is in violation of Rule 15c 3-1, the net capital rule. Since a violation of the net capital rule can result in the imposition of criminal penalties under Section 32 of the

Securities Exchange Act, it is clear that Rule 17a-5 is unconstitutional under Haynes v United States, supra; Marchetti v United States, supra and Grosso v United States, supra.

Rule 17a-4 need not be discussed here since the S.E.C. did not find that Sloan violated that rule (A52 n. 6) so all that remains is Rule 17a-3. This rule is unconstitutional because it undermines the "required records" standards set forth in Shapiro v United States, supra; Marchetti v United States, supra and Grosso v United States, supra. The foregoing cases require that the records and reports be ones that would "customarily" be kept, that they must have some specific "public aspect," and that they must have arisen out of an "essentially non-criminal and regulatory area of inquiry." Marchetti v United States, supra 390 U.S. at 57. These criteria are not satisfied here and hence Rule 17a-3 is unconstitutional.[13]

Finally, all of the rules in question here were promulgated in an unconstitutional exercise of legislative power by an administrative agency. See National Cable Television v United States 415 U.S. 336, 342 (1974); Federal Power Commission v New England Power Co. 415 U.S. 345, 350 n. 4 (1974). Hence, the order of the Securities and Exchange Commission must be set aside.

13. The various principles just cited were discussed in detail by several Supreme Court justices in California Bankers Association v Schultz 416 U.S. 21 (1974). A reading of all of the opinions expressed there leaves no doubt that a majority of the Supreme Court would be prepared to declare the S.E.C. rules in question here to be unconstitutional.

CONCLUSION

For all of the reasons set forth above, the order of the Securities and Exchange Commission must be vacated and set aside.

DATED: New York, New York
May 14, 1976

Respectfully submitted,

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STATE OF NEW YORK)
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ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 24 day of May 1976 deponent served the within Brief upon:

Securities and Exchange Commission

attorney(s) for

Respondent

in this action, at

500 N. Capitol
Washington, D.C. 20549

the address(es) designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Robert Bailey
Robert Bailey

Sworn to before me, this 24
day of May, 1976

William Bailey
WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1977